Debt Management Performance Assessment (DeMPA)

Papua New Guinea

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ECONOMIC POLICY AND DEBT DEPARTMENT
Sound Economics for Growth and Poverty Reduction

TREASURY
THE WORLD BANK

The DeMPA is a methodology for assessing public debt management performance through a comprehensive set of indicators spanning the full range of government debt management functions. It is adapted from the Public Expenditure and Financial Accountability (PEFA) framework. The DeMPA tool presents the 15 debt performance indicators along with a scoring methodology. The DeMPA tool is complemented by a guide that provides supplemental information for the use of the indicators.

For additional information on the World Bank's Debt Management Technical Assistance Program, including more on the DeMPA Tool, please visit our website at: http://www.worldbank.org/debt

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Acronyms

ADB	Asian Development Bank
ANZ	Australia and New Zealand Banking Group Limited
BPNG	Bank of Papua New Guinea
BDM	Banking and Debt Management
BSP	Bank South Pacific Limited
ComSEC	Commonwealth Secretariat
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DeMPA	Debt Management Performance Assessment
DNPM	Department of National Planning and Monitoring
DPIs	Debt management performance indicators
DSA	Debt sustainability analysis
DSF	Debt Sustainability Framework
EAP	East Asia and Pacific
FED	Financial Evaluation Division
FDI	Foreign direct investment
GDP	Gross domestic product
IMF	International Monetary Fund
IPBC	Independent Public Business Corporation of PNG
LNG	Liquefied natural gas
MDGs	Millennium Development Goals
MTDP	Medium-term Development Plan
MTDS	Medium-term debt management strategy
N/R	Not rated
NEC	National Executive Council
NPL	Non-performing loan
NSO	National Statistics Office
OCR	Ordinary Capital Resources
PDC	Public Debt and Cash Flow Committee
PNG	Papua New Guinea
PNK	Papua New Guinea Kina
PRMVP	Poverty Reduction and Economic Management Network, Office of the Vice President
SOEs	State-owned enterprise
SPID	Structural Policy and Investment Division of the Department of Treasury
T-bills	Treasury bills
USD	U.S. dollar
WPA	Waigani Public Account

Executive Summary

At the request of the Government of Papua New Guinea (PNG), a mission comprised of Jeff Chelsky (PRMVP, mission lead), Tomas Magnusson (BDM, consultant), Greg Horman (BDM, consultant) and Tim Bulman (EAP, country economist), visited Port Moresby between November 22nd and December 3rd to undertake a DeMPA exercise. The team met with officials from the Department of Treasury, Bank of Papua New Guinea, Department of Finance, Department of National Planning and Monitoring, State Solicitor's Office, Auditor General's Office, Independent Public Business Corporation (IPBC), AUSAid, Asian Development Bank, ANZ Bank, Nambawan Super, and Bank South Pacific (BSP). This report reflects comments received from the PNG authorities in February 2011.

The mission found that, in a number of areas, PNG meets or exceeds minimum DeMPA requirements. Strengths include the quality of the debt management strategy, the framework for domestic debt issuance, coordination with monetary policy, and the legal framework (except for the issuance of T-bills for which the law contains no explicit borrowing purposes).

Weaknesses include disclosure and publication of information on debt activities, audit (there is currently no internal audit function in the Department of Treasury nor has there been an external audit of debt management processes and procedures), guarantee issuance, and business continuity. The only central government guarantees issued in the last five years were with respect to the PNG LNG Project, but the process and transparency surrounding these very large transactions requires improvement.

In several areas, while the authorities did not score high, reforms are underway. This is particularly the case with respect to the structure of the principal debt management entity, the Financial Evaluation Division (FED) in the Department of Treasury, for which a restructuring plan has already been adopted, and on-lending (for which a policy is being developed and is expected to be completed by early 2011). While the policy and procedures for contracting and recording external debt are essentially sound, these have not been documented, and no effort has been made to make use of the flexibility in lending terms provided by some creditors, which resulted in a low score for this dimension of the DeMPA. While no statistical debt bulletin is currently prepared, the capacity to prepare one appears to exist within FED which produces an internal Quarterly Management Bulletin on Central Government Debt that contains much of the information and analysis required. Moreover, FED recently produced its own Debt Sustainability Analysis (DSA), building on the recent IMF-WB DSA. Were this practice to be regularized, and the results disseminated more widely, the authorities would have exceeded the minimum requirement.

1 Background

1.1 Country Background

PNG has enjoyed markedly improved economic fortunes since the mid-2000s. The global commodity price boom and stronger macroeconomic management underlie much of the reversal from the declining real incomes and macroeconomic volatility of the preceding 10 years. The global downturn of 2009 had only a mild impact on PNG's economy, which expanded by 5.5 percent, outperforming most other developing economies and its regional peers. This follows several years of 6 to 7 percent annual GDP growth. While sharply higher global commodity prices have supported incomes (average export prices doubled between 2005 and 2008, and were still two-thirds higher in late 2010), the non-minerals sector has led this resurgence, benefiting from private investment in newly liberalized telecommunications and aviation sectors, for example.

Improved fiscal management has done much to transform windfall gains from higher commodity prices into sustained growth. The 2006 Fiscal Responsibility Act required that a portion of 'excess' government mineral receipts associated with the rise in global commodity prices be used to pay down relatively expensive external loans and the government's unfunded superannuation liabilities. These accumulated surpluses then funded significant off-budget spending, resulting in a fiscal impulse of as much as 13 percent of GDP in 2009-10–well in excess of that permitted under the medium term fiscal strategy but with a less-than-proportionate impact on growth.

PNG's financial sector has been a source of strength for the economy, detached from the instability elsewhere and characterized by excess short-term liquidity. Non-performing loans (NPL) levels are low and stable and capital reserves are high. Credit growth, while strong in recent years and strengthening into late 2010, is modest relative to likely nominal GDP growth although this may be a factor driving strong increases in urban property prices. Excess liquidity has reduced BPNG's ability to conduct monetary policy. While the overnight policy rate has been held at 7.0 percent through 2010, this has only acted as a floor for lending rates. Deposit rates are determined more by short-term money market rates, which have ranged around 3 percent in 2010.

Optimism surrounds PNG's medium-term economic outlook. A USD 15 billion LNG production investment was approved at the turn of 2010, to be constructed in 2010-2013 with full production currently scheduled for 2014. The Government expects the economic impetus from this project to expand GDP by one-quarter in 2014 and 2015 (little of the construction activity is expected to be retained in the local economy), and national income by about 8 percent. This project will more than offset the waning revenues from aging mines and oil wells expected to begin in 2013, although there may be a short-term revenue gap, creating some financing risks just as LNG construction activity winds down. Other, smaller LNG and minerals projects are in development and increasingly likely.

But as the Government recognizes, risks to PNG's outlook are significant. In the short-term, after slowing to low single-digits during the global downturn, inflation has returned to the peaks experienced during the 2007 food price crisis, but now due to domestic demand pressures and capacity constraints. The National Statistics Office (NSO) reports that consumer prices rose by nearly 6 percent in the year to Q3 2010, although this likely understates substantially the true inflation rate due to significant capacity, measurement and methodological issues at the NSO. Inflation is likely to remain near current levels in the near term. The supply constraints causing this, particularly of skilled labor, in the construction sector and for land for development, are also

limiting scope for higher output growth and the efficiency of government development spending.

Expectations are mounting throughout the country that growth in output over the medium term will translate into improved living standards. PNG's human development indicators have lagged economic recovery and progress to the MDGs has fallen short. The Government has developed long- and medium-term development strategies devoted to these issues, particularly growth of the non-minerals private sector, and is investing considerable resources in developing social protection mechanisms, for example. Towards ensuring the macroeconomic benefits are sustainable and limiting the impact of global commodity price volatility, the 2011 budget commits to managing minerals revenues through sovereign wealth funds located offshore, and to maintaining the medium-term fiscal strategy.

1.2 Debt and Debt Sustainability Outlook

Papua New Guinea has made considerable progress in reducing its debt burden, with the ratio of public-sector debt to GDP having declined from 62 percent of GDP at end-2004 to an estimated 32 percent of GDP by end-2009.[1] The share of T-bills and other short term credit in domestic debt was 43 percent (end-2009). While down from 53.9 percent in 2005, it remains above of the Government's target of between 15 and 30 percent. The average maturity of domestic debt, at 4.3 years, is below the medium-term debt strategy (MTDS) target of 5 years. Public and publicly-guaranteed (central government) external debt has also decreased from over 50 percent of GDP in 2001 to below 13 percent in 2009.[2] Over 90 percent of external debt is held by multilateral institutions. A small portion (less than 3 percent) is commercial debt. The rapid decline in debt ratios is the result of a combination of strong GDP growth in the face of high commodity export prices and a policy decision to allocate 30 percent of revenues in excess of 4 percent of GDP to debt reduction. This has enabled the authorities to offset the recent (i.e., 2009) circumvention of budget and debt controls.

The IMF-WB baseline debt sustainability analysis shows a slight increase in the present value of external debt and debt service ratios in the medium term due to disbursements of previously approved ADB loans but ratios are projected to decline in the longer term, leaving them well below indicative debt sustainability thresholds over the projection period. However, standard stress tests of slower export growth or lower FDI inflows would raise the present value of the external debt-to-GDP ratio over the medium term. Of particular concern is the impact on the public-sector debt burden of potentially slower GDP growth, persistent primary budget deficits or the realization of risks to the outlook from large contingent liabilities associated with the LNG project, SOE borrowing and off-balance sheet liabilities, and/or Government commitments to landowners.[3] For these reasons, the IMF has assessed PNG to be at a moderate risk of debt distress for both external and public-sector debt.

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[1] According to the DSA undertaken as part of the IMF's 2010 Article IV consultation, May 2010.

[2] Total public and publicly-guaranteed central government external debt amounted to just over USD 1 billion at end October 2010.

[3] State liabilities in addition to Central Government debt include the Independent Public Business Corporation's (IPBC) borrowing to fund its share of the PNG LNG project of AUD 1.7 billion (PGK 4.3 billion or about 20 percent of 2009 GDP)) and the State's share of the PNG LNG project debt (PGK 5.3 billion or 25 percent of 2009 GDP) which is guaranteed by the State until the project construction reaches completion. Through these liabilities, the State's finances are heavily exposed to the success of the PNG LNG project. In addition, the State has unfunded public service superannuation liabilities of PGK 1.9 billion (about 9 percent of 2009 GDP).

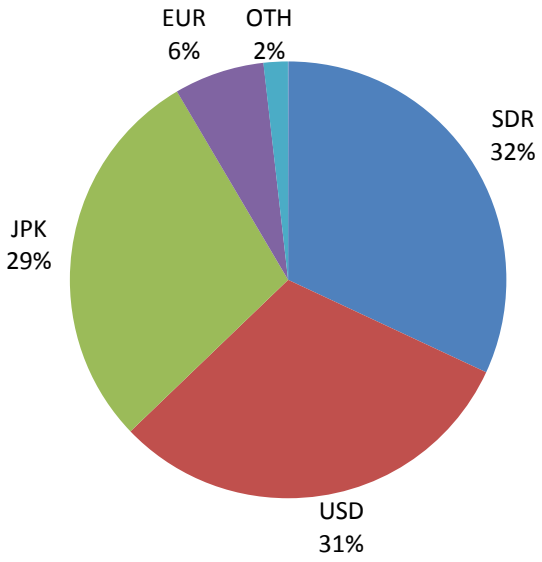
FED has undertaken, for the first time, its own internal DSA, building on the results of that undertaken for the most recent IMF Article IV consultation, and taking into account the debt of state-owned enterprises as well as central government guarantees associated with the PNG LNG Project. Given the significance of the PNG LNG Project to central government finances, the analysis contains a "worst case" scenario in which the LNG project does not proceed. Under this scenario, central government external debt in 2014 is higher by 30 percent of GDP, and exceeds the debt sustainability threshold. In NPV terms, the debt stock exceeds the IMF threshold under the Debt Sustainability Framework (DSF) although external debt service as a share of GDP remains below DSF parameters. The "worst-case" scenario is also subject to stress tests involving shocks to GDP growth, the exchange rate, interest rates and export growth.

Looking ahead, the Government has expressed its intention, as part of the 2011 Budget and its updated 2011 Medium-term Debt Management Strategy, to remove the nominal cap on external debt, replacing it with a cap of 30 percent of GDP. The commitment to allocate a portion of excess government revenue to debt reduction will only apply when the debt-to-GDP ratio exceeds 30 percent of GDP. At the same time, the Government has reiterated its commitment to reducing the exchange rate risks to its debt portfolio by targeting 40 percent of total debt over the medium term for the external portion of the portfolio. Interest rate risk will be reduced through continued efforts to extend the maturity of domestic debt.

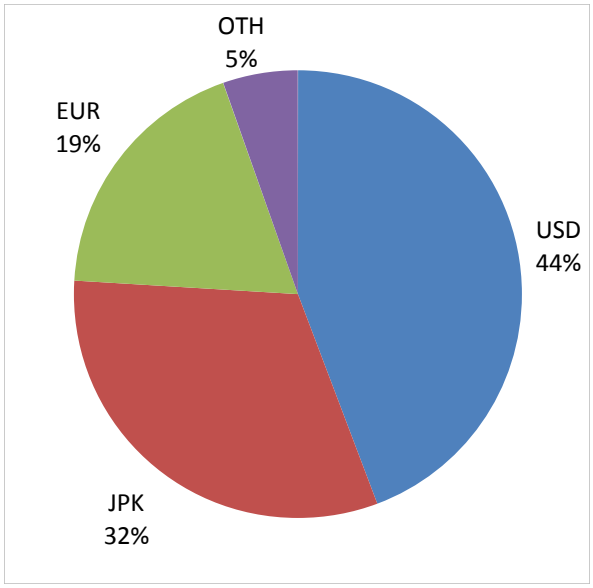
Currency Composition of PNG's External Debt

(Debt stock as of October 31, 2010)[1]

Including SDR-denominated debt



SDR-denominated debt broken into constituent currencies (December 30, 2010 weights)



Source: PNG authorities, staff calculations,

[1] exchange rates as at December 30, 2010

1.3 Recent and On-going Reforms

The PNG government has been engaged in a long-term, ongoing program to strengthen public finance management systems, especially over the past decade. AusAID has funded a sizable team of technical advisors for key areas of the Departments of Treasury and Finance related to debt management under the Strongim Gavman Program. These advisors have generally been recruited from corresponding areas of the Australian government and have provided both day-

to-day operational support and been instrumental in the development of the medium-term debt management strategy. In addition, PNG has received ongoing technical support from ComSEC, both remotely and through focused technical and diagnostic missions. These missions have also supported the debt management unit to develop its institutional structure. The ADB has provided various focused technical support missions, most recently for the development of the domestic debt market. Finally, the debt management unit has its own extensive program of training and internal capacity building, with various degrees of formality, and drawing on offerings from a variety of local and international agencies.

2 DeMPA Assessment

2.1 Scoring Methodology[4]

The DeMPA comprises a set of 15 Debt Management Performance Indicators (DPIs), comprising 35 dimensions of debt management and encompassing the full spectrum of government debt management (DeM) operations, as well as the overall environment in which these operations are conducted. While the DeMPA does not provide recommendations on reforms and/or capacity and institution building needs, the performance indicators do stipulate a minimum standard that should be met under all conditions. Consequently, if the assessment shows that the minimum requirements are not met, this will clearly indicate an area requiring attention or priority reform.

The scope of the DeMPA is central government debt management activities and closely related functions such as issuance of loan guarantees, on-lending, and cash flow forecasting and cash balance management. Thus, the DeMPA does not assess the ability to manage the wider public debt, including implicit contingent liabilities (such as liabilities of the pension system, losses of SOEs, etc.), as well as debt of SOEs, if these are not guaranteed by the central government.

The DPIs have one or more dimensions linked to the subject of the DPI. The scoring methodology assesses each dimension separately and assigns a score of either A, B or C based on the criteria listed. The evaluation starts by checking whether the minimum requirement for that dimension has been met, corresponding to a score of C. A minimum requirement is the necessary condition for effective performance under the particular dimension being measured. If the minimum requirements set out in C are not met, then a D score is assigned. In the cases where a dimension cannot be assessed, an N/R (not rated or assessed) score is assigned. The A score reflects sound practice for that particular dimension of the indicator. The B score is an in-between score lying between the minimum requirements and sound practice.

[4] This assessment uses the December 2009 version of the DeMPA tool.

Summary of the Assessment

Indicator and Dimension		Score
DPI 1	Existence, coverage, and content of the legal framework	D
DPI 2	1. Managerial structure for central government borrowings and debt-related transactions	A
	2. Managerial structure for preparation and issuance of central government loan guarantees	D
DPI 3	1. Quality of the debt management strategy document	B
	2. Decision-making process, updating, and publication of the debt management strategy	D
DPI 4	Level of disclosure, in an annual report or its equivalent, of government debt management activities, central government debt, evaluation of outcomes against stated objectives, and compliance with the government's debt management strategy	D
DPI 5	1. Frequency of internal and external audit of central government debt management activities, policies, and operations, as well as publication of external audit reports	D
	2. Degree of commitment to address the outcomes from internal and external audits	N/R
DPI 6	1. Coordination with fiscal policy through the provision of accurate and timely forecasts of total debt service under different scenarios	C
	2. Availability of key fiscal variables, and an analysis of debt sustainability and the frequency with which it is undertaken	C
DPI 7	1. Clarity of separation between monetary operations and debt management transactions	B
	2. Coordination through regular information-sharing on current and future debt transactions and the central government's cash flows with the central bank	A
	3. Extent of a limit to direct access of resources from the central bank	C
DPI 8	1. Extent to which market-based mechanisms are used to issue debt, the publication of a borrowing plan for treasury bills and bonds, and the preparation of an annual plan for the aggregate amount of local-currency borrowing in the domestic market, divided between the wholesale and retail markets	A
	2. Availability and quality of documented procedures for local-currency borrowing in the domestic market	A
DPI 9	1. Degree of assessment of the most beneficial/cost-effective borrowing terms and conditions (lender of funds, currency, interest rate, and maturity)	D
	2. Availability and quality of documented procedures for external borrowings	D
	3. Availability and degree of involvement of legal advisers before signing of the loan contract	B
DPI 10	1. Availability and quality of documented policies and procedures for approval and issuance of central government loan guarantees	D
	2. Availability and quality of documented policies and procedures for on-lending of borrowed funds	D
	3. Availability of a debt management system with functionalities for handling derivatives, as well as availability and quality of document procedures for the use of derivatives	N/R
DPI 11	1. Effectiveness of forecasting the aggregate level of cash balances in government bank accounts	C
	2. Effectiveness of managing the aggregate cash balance in government bank accounts, including integration with the domestic borrowing program	C
DPI 12	1. Availability and quality of documented procedures for the processing of debt service	D
	2. Availability and quality of documented procedures for debt data recording and validation, as well as storage of agreements and debt administration records	D
	3. Availability and quality of documented procedures for controlling access to the central government's debt data recording and management system	D
	4. Frequency and off-site, secure storage of debt recording and management system back-ups	D
DPI 13	1. Segregation of duties for some key functions, as well as the presence of a risk monitoring and compliance function	D
	2. Staff capacity and human resource management	C
	3. Presence of an operational risk management plan, including business-continuity and disaster-recovery arrangements	D
DPI 14	1. Completeness and timeliness of central government debt records	D
	2. Complete and up-to-date records of all holders of government securities in a secure registry system	A
DPI 15	1. Meeting statutory and contractual reporting requirements of central government debt to all domestic and external entities	C
	2. Meeting statutory and contractual reporting requirements for total non-financial public sector debt and loan guarantees to all domestic and external entities	D
	3. Quality and timeliness of the publication of a debt statistical bulletin (or its equivalent) covering central government debt	D

Assessment of Individual Indicators

2.1.1 DPI-1 Legal Framework

Dimension	Score
The existence, coverage, and content of the legal framework	**D**

The legal framework for central government debt management is included in the Constitution of 1975, separate Acts of the Parliament regulating borrowing from particular sources and by the use of certain instruments, and in the *Public Finances (Management) Act (1995)* and the *Fiscal Responsibility Act (2006)*.

The Constitution vests the power to borrow on behalf of the central government (the State) in the Parliament. According to Section 209, "the raising of loans is subject to authorization and control by the Parliament, and shall be regulated by an Act of the Parliament."

Borrowing from "international assistance agencies" and "international finance agencies" is regulated by the *Loans and Assistance (International Agencies) Act (1971)*. Borrowing from these foreign entities must be approved by the National Executive Council (NEC)[5], and be for the purpose of financing a program or project already approved by the NEC and the Parliament within the framework of the Government's Budget and Public Investment Program, or for purposes otherwise approved by the NEC. A loan agreement shall be entered into and executed by the Minister for Treasury and Finance. In addition, Parliament must be informed about the borrowing as soon as practicable thereafter.

The *Loans (Overseas Borrowings) Act (1973)* regulates borrowing from "overseas financial institutions". These borrowings must be approved by the Head of State, acting on advice of the NEC. Loans shall be used to finance "works and services of the Government", and also for on-lending to certain institutions.

The *Loans Securities Act (1960)* regulates issuance of bonds in the domestic market, both capital stock (in the form of inscribed stock) and bearer bonds.[6] At present, only inscribed stock is issued. Inscribed stock must be created by the Head of State, acting on advice of the NEC. In practical terms, the NEC on an annual basis asks the Head of State to delegate to the Minister for Treasury and Finance the authority to issue inscribed stock up to a certain amount. For 2010, this was set at PGK 252.8 million. The Act prescribes that the stock can be issued for the purposes of refinancing and for any other borrowing purpose "granted by an Act".

The *Treasury Bills Act (1974)* regulates the issue of Treasury Bills (T-bills) in the domestic market. The Minister may borrow through the issue of T-bills in the domestic market such amount in any financial year as the Minister considers appropriate. The maturity of T-bills must not extend beyond one year. In comparison with the other Acts that provide the mandate for the Government to borrow, the *Treasury Bills Act* does not restrict borrowing to certain purposes.

Finally, the *Central Banking Act (2000)* allows the Government to borrow directly from the Bank of Papua New Guinea (BPNG) by using a temporary advance facility. This facility can only be used to fund temporary deficiencies of revenue due to cash flow mismatches. It is explicitly stated that it cannot be used for deficit financing. The tenor of these loans is limited to six months. According to the *Public Finances (Management) Act*, only the Minister for Treasury and Finance is authorized to use this facility.

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[5] The NEC consists of all the Ministers (including the Prime Minister when he is present as Chairman).

[6] The bearer bonds are called Treasury Bonds.

The Minister has the right to delegate his/her borrowing power in accordance with the *Ministers (Delegation) Act*. In case of issuance of Inscribed Stock and T-bills, the Minister has delegated the right to accept bids in the auctions to the Secretary of the Department of Treasury and to the Deputy Secretary for Economic & Financial Policy. The Secretary has in turn delegated this right to the First Assistant Secretary (i.e. the Head) of the Financial Evaluation Division (FED), which is the principal debt management entity.[7]

The *Public Finances (Management) Act* provides clear authorization to the Minister for Treasury and Finance to issue loan guarantees on behalf of the central government, provided the loan was made for purposes approved by the Head of State, acting on advice. Where the Minister has guaranteed the repayment of a loan, he shall, at the first sitting of the Parliament following the giving of the guarantee, table the documents relating to the guarantee.

Overall, the legal framework provides clear authorization to borrow and to issue new debt, and to issue loan guarantees. The primary legislation for T-bill issuance, however, does not restrict borrowing to specified purposes, leaving it to the Minister or his delegate to decide the purpose of the borrowing.[8] Thus, the minimum requirements are not met.

2.1.2 DPI-2 Managerial Structure

Dimensions	Score
1. The managerial structure for central government borrowings and debt-related transactions	A
2. The managerial structure for preparation and issuance of central government loan guarantees	D

Dimension 1: Central government debt management is the responsibility of FED which has the lead in the annual update of the debt management strategy, negotiates the terms of all foreign borrowing, prepares the domestic debt issuance program, records all debt data in the debt recording system (CS-DRMS), keeps records of outstanding loan guarantees, and manages government on-lending. It is organized into four branches based on borrowing source--the World Bank Branch, ADB Branch, Bilateral and Commercial Debt Branch, and Domestic Debt Branch.[9] In addition, there is one unit responsible for the debt recording system (the CS-DRMS Unit). Each year, FED prepares a medium-term debt management strategy which is approved by the NEC and forms part of the annual budget. FED officials indicated that borrowings are generally in line with the approved strategy and undertaken without undue political interference.[10]

[7] FED is a division within Department of Treasury, which also is responsible for budget preparation and debt-related policies. Budget execution and accounting are the responsibility of the Department of Finance.

[8] In general, the borrowing purposes are not very specific. For instance, one could question the general mandate of NEC to decide for what purpose loans from International Financial Institutions and bilateral agencies should be used. Allowing the executive branch to borrow to finance expenditures not clearly approved by the Parliament undermines the integrity of the budget process.

[9] T-bill and inscribed stock auctions are run by the BPNG under an agency agreement with the Department of Treasury. All successful bids must be approved by the Head of FED.

[10] The mission was told that some earlier loans from one particular external creditor were not in accordance with aspects of the debt management strategy. However, FED officials indicated that, after raising their concerns with NEC, subsequent loans have been better aligned with the strategy.

Because borrowings are steered by a formalized debt management strategy and undertaken by the principal debt management entity (i.e., FED) without undue political interference, the first dimension receives an "A".

Dimension 2: Four loan guarantees have been issued in the last 5 years, three related to the LNG project (two counter-guarantees covering IPBC's and Petromin's guarantees to support the LNG loan financing during the completion phase, and one direct guarantee by the central government for the same purpose). The fourth was extended on behalf of the Civil Aviation Authority to finance their organizational restructuring. Meaningful coordination with the principal debt management entity (FED) did not take place, and the guarantees issued were not part of the FED-authored debt management strategy. Therefore the minimum requirement for this dimension is not met.[11]

2.1.3 DPI-3 Debt Management Strategy

Dimensions	Score
1. The quality of the debt management strategy document	B
2. The decision-making process, updating, and publication of the debt management strategy	D

Dimension 1: A medium-term (5–year) debt management strategy (MTDS) for total central government debt is prepared annually on a rolling basis. Strategy development is the responsibility of FED. The strategy for 2011-2015 is based on qualitative analysis. Financial and macroeconomic assumptions are consistent with the 2011 Budget.

The strategy specifies the Government's debt management objectives (goals), which are currently to minimize the cost of debt consistent with the Government's tolerance for financial risk. The strategy has three main components: (i) to maintain debt at sustainable levels; (ii) to change the composition of the debt portfolio so as to maintain financial risk at prudent levels; and (iii) to develop the domestic debt market.[12] Taking into account the existence of significant contingent liabilities, the strategy includes target levels for indicators of foreign currency risk, interest rate risk, and refinancing risk.[13]

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[11] The IPBC (Independent Public Business Corporation of PNG), Petromin PNG Holdings Limited, and the central government each have an ownership stake in the LNG project. Each has issued a guarantee covering the loan financing of the project (70 percent of the investment cost) in proportion to its shareholding. The guarantees will terminate at the completion of the project. To support the IPBC and Petromin guarantees (both SOEs), the central government has issued two counter-guarantees. In total, the central government is guaranteeing around USD 2.1 billion of the loans (out of a total financing cost of USD 15 billion). The FED, which is responsible for keeping track of all government guarantees, did not have documentation on these guarantees (they eventually obtained the requisite parliamentary submissions on the guarantees at the end of the mission, in response to a request from the team). The mission team was informed that these guarantees were handled at a "higher level" of the Government.

[12] While development of a domestic debt market is an explicit part of the strategy, no measures to achieve this are articulated in the MTDS. However, work has begun with the support of a technical assistance grant from the ADB.

[13] The strategy document also states that debt to GDP should be kept at or below 30 percent, and that in the event that debt increases above this level the Government will use budget surpluses and windfall revenue to reduce its liabilities. Consistent with the strategy, the *Fiscal Responsibility Act* was recently amended to replace the requirement that the overall level of debt will not be raised with a ceiling on the debt-to-GDP ratio of 30 percent.

To keep foreign currency risk within an acceptable range, the Government aims to maintain foreign currency debt at around 40 percent of total central government debt by restricting new foreign currency borrowing. The following criteria are to guide new foreign currency borrowing: (i) the loan is highly concessional (i.e., with a grant element of at least 35 percent) and in a low risk currency[14]; (ii) the associated project is a high priority under the *Medium Term Development Strategy* and will not significantly increase the level of external debt above 40 per cent of the total debt portfolio or increase the level of central government debt above 30 per cent of GDP; (iii) the lender's policies do not preclude awarding of contracts to PNG firms and/or awarding of contracts via international competitive bidding; and (iv) there is a genuine advantage to funding the project from foreign currency loans, such as the need to import foreign expertise and/or foreign materials.

On interest rate risk, the current level of T-bills of around 36 percent of the domestic portfolio will be reduced to between 15 and 30 percent over the next five years, and the level of inscribed stock will be increased from 64 percent to between 70 and 85 percent.

To keep refinancing risk at a tolerable level, the strategy seeks to maintain the weighted average maturity at about 5 years for the domestic debt portfolio, and about 8 years for foreign-currency debt. Furthermore, the Government will maintain the maximum maturity of inscribed stock at 17 years, and limit the amount of inscribed stock maturing in any one year to PGK 500 million.

To summarize, the MTDS is based on clear debt management objectives, has explicit targets for interest rate, refinancing and foreign currency risks (based on a qualitative analysis), and contains the minimum target of the grant element in external borrowing. The requirements for the "B" score are met. For the "A" score, target levels for risk indicators would need to be based on thorough analysis of costs and risks, identifying the vulnerability of the debt portfolio to shocks in market rates, and these analyses would need to be clearly described in the strategy, setting out the assumptions made and any limitations to the analyses.

Dimension 2: The strategy is prepared by FED in close cooperation with the Economic Policy Division of Treasury and approved by the Minister and the NEC. Once approved, the debt management strategy is included in the budget documentation sent to Parliament and published along with the annual budget. However, according to FED, the central bank (BPNG) is not systematically consulted in the preparation of the formal strategy, a requirement for this dimension. The minimum requirement for this dimension is therefore not met.

2.1.4 DPI-4 Evaluation of Debt Management Operations

Dimension	Score
Level of disclosure—in an annual report or its equivalent—of government DeM activities, central government debt, evaluation of outcomes against stated objectives, and compliance with the government's debt management strategy	D

As required by the *Fiscal Responsibility Act*, a summary of the central government's financing activities during the budget year and its debt position is prepared as part of the *Final Budget Outcome* report to Parliament. This year's report provides information on the budget deficit and how it was financed through net domestic borrowing and a reduction in the cash balance. It also includes a table of public debt for 2008 and 2009, broken down by funding source. No

[14] "Low risk currency" is not defined in the strategy document. When asked, FED identified the renminbi as a currency that was not "low risk" given its potential to appreciate in value.

details are provided on the debt management activities during the year, which is one of the minimum requirements for this dimension. While much of the required information and analysis is contained in the FED's *Quarterly Management Report*, this document is not provided to Parliament or published. Therefore the minimum requirement for this indicator is not met.

2.1.5 DPI-5 Audit

Dimensions	Score
1. Frequency of internal and external audit of central government debt management activities, policies, and operations, as well as publication of external audit reports	D
2. Degree of commitment to address the outcomes from internal and external audits	N/R

The functions of the Auditor-General's Office are regulated by the Constitution and the *Audit Act (1989)*. The mandate is broad and includes audit of central government debt management activities, policies and operations. So far, however, the Auditor-General's Office has audited only the public accounts, including the debt figures, as part of the annual financial audit. A new performance audit unit has recently been established within the Auditor-General's Office, and the plan is to start conducting performance audits in the near future.

The Department of Treasury has no internal audit function, despite a legislative requirement introduced in 2004 that all government departments establish one.

To meet the minimum requirements for this indicator--an external audit of government debt management activities, policies and operation--must have occurred within the past five years. This requirement is not met. In light of this, the second dimension is not rated.

2.1.6 DPI-6 Coordination with Fiscal Policy

Dimensions	Score
1. Coordination with fiscal policy through the provision of accurate and timely forecasts on total debt and debt service under different scenarios	C
2. Availability of key fiscal variables and an analysis of debt sustainability, and the frequency with which it is undertaken	C

<u>Dimension 1</u>: Annual debt service projections are updated quarterly in the context of the *Quarterly Management Report on Central Government Debt* prepared by the principal debt management entity (FED) which is circulated only within Department of Treasury, including the Budget Division, although there are plans to distribute it more widely to other departments and official entities with an interest in debt and debt management (e.g., BPNG, Department of National Planning and Monitoring). These projections include loans that have been signed and are effective, those to become effective in the current year, and those still in the pipeline. This meets the minimum requirement for this dimension. A higher score would require sensitivity analysis of the base case to interest and exchange rate shocks.

<u>Dimension 2</u>: Forecasts of key macroeconomic policy variables are prepared by officials in the Economic Policy Division at least three times a year; an internal forecast is prepared in April, a mid-year forecast is prepared in June for the *Mid-Year Economic and Fiscal Report* and an October update is done for the purposes of the annual budget. Both the *Mid-Year Report* and the Budget are available on the Department of Treasury's website.

Using the above information, FED recently prepared a comprehensive debt sustainability analysis, building on the one undertaken for the IMF's 2010 Article IV consultation and including the debt of state-owned entities. However, while being of sufficient quality, this was an experimental exercise and the results were not distributed widely. The DSA contains sensitivity analysis and scenario analysis including a "worst case scenario" based on the failure of the LNG project to proceed. The substance of the DSA therefore meets the minimum requirement for this dimension. However, this DSA is not undertaken on a regular basis. To obtain a "B" score, the preparation of the DSA would need to be formalized and undertaken at least every two years.

2.1.7 DPI-7 Coordination with Monetary Policy

Dimensions	Score
1. Clarity of separation between monetary policy operations and debt management transactions.	B
2. Coordination through regular information sharing on debt transactions and central government's current and future cash flows with the Central Bank	A
2. Extent of a limit to direct access of resources from the Central Bank	C

Dimension 1: The relationship between the government and BPNG is set forth in the *Central Banking Act (2000)*. Notably, the law establishes that an objective of the central bank is to achieve and maintain price stability (Article 7). The central bank may also act as banker to, and financial agent of, the government (Article 51). In that capacity, it is the official depositary of the government, accepts deposits from it, and effects payments on its behalf (Article 52). In addition, the government and the central bank may establish agency agreements (Article 53). To that end, the services that BPNG provides to the government have been codified in a formal agency agreement. That agreement is not publicly available due to opposition to its publication from BPNG.

BPNG implements monetary policy through the issuance of central bank bills and use of reserve requirements. Although auctions of central bank bills and T-bills occur at the same time, central bank bills are issued typically with tenors of 28 and 63 days, whereas T-bills are normally issued with tenors of six and 12 months. The issuance of central bank paper is governed at the operational level by a prospectus (*Terms and Conditions for the Auction of Central Bank Bills*) available on the website of the BPNG. The rules and mechanics are similar to those for T-bills; the main difference is that only commercial banks and other licensed deposit-taking institutions may bid for central bank paper, while eligible participation is wider for government securities. Market participants report that the distinction between monetary-policy implementation and deficit-financing operations is well understood, and that sufficient information regarding transactions is made available.

The requirements for a score of "B" are met for the first dimension. A higher score would require that the agency agreement between the government and BPNG is publicly available.

Dimension 2: There is good coordination of information between the government and BPNG on government cash flows, including ordinary receipts, proceeds of planned debt issuance, debt service payments, and other expenditures, as well as the liquidity conditions in the domestic money market. This is achieved primarily through the Public Debt and Cash Flow Committee (PDC), which convenes on a weekly basis, with representation from Treasury, BPNG, Department of Finance, and Department of National Planning. The requirements for a score of "A" are met for the second dimension.

Dimension 3: Under the *Central Banking Act*, BPNG may extend credit to the government (Article 55), and this has been formalized at the operational level in an agency agreement. The

purpose of advances is limited to covering temporary deficiencies arising from mismatches in cash flow timings; the central bank may not finance a fiscal deficit. The government accesses this overdraft only infrequently. The maximum allowable term of an individual overdraft drawing is six months, and the total amount of all overdrafts outstanding may not exceed PGK 112 million. The rate of charge payable on overdrafts is reset weekly, based on the weighted-average yield of the six-month T-bill most recently auctioned; interest is calculated daily and paid monthly. The government is obliged to clear any overdraft as soon as practicable, and no remuneration is paid on positive government balances in the treasury single account if an overdraft is outstanding.

The *Central Banking Act* allows for BPNG to purchase government securities at market-determined prices, for the purpose of monetary policy management. In practice, the central bank acquires government securities by participating directly in the primary market with competitive bids. BPNG participates in the auctions under the same terms as private participants. It does not enjoy an information advantage when submitting bids, which are not guaranteed of success.

The minimum requirements for a score of C are met. To get a higher score, the tenure of credit extended to the government would need to be shortened to no more than three months.

2.1.8 DPI-8 Domestic Market Borrowing

Dimensions	Score
1. The extent to which market-based mechanisms are used to issue debt, the publication of a borrowing plan for T-bills and T-bonds, and the preparation of an annual plan for aggregate amount of local currency borrowing in the domestic market, divided between the wholesale and retail markets	A
2. The availability and quality of documented procedures for local currency borrowing in the domestic market	A

Dimension 1: The government borrows in the domestic market through T-bills and inscribed stock (i.e., bonds) denominated in local currency. Zero-coupon T-bills are issued on a roughly weekly basis with tenors typically of six and 12 months. Inscribed stock is currently being issued at fixed rates with maturities of two, 10, and 17 years. All of these instruments are issued on market terms; there is no captive placement with public or quasi-public investors. No instruments are specifically designed for retail investors, although retail investors may acquire T-bills and inscribed stock directly or through commercial banks.

FED is the entity responsible for raising domestic financing for the government. Under the *Central Banking Act*, BPNG assists in that activity through its role as banker to, and financial agent of, the government (Article 51). However, all decisions regarding the volume and timing of issuance are exclusively those of the government.

The government aims to be a predictable and transparent issuer in the domestic market. To that end, after the budget is passed, as well as following the mid-year update, FED announces the funding arithmetic for the year, with planned gross and net issuance of T-bills and inscribed stock. FED also publishes the auction calendar for the year, containing auction dates and indicative amounts. Customarily, inscribed stock is issued once per month, while T-bills may be offered as often as weekly. Aggregate monthly volumes are updated in the calendar on a quarterly basis, while the volumes of the specific maturities to be offered are announced monthly. Thus the calendar is updated each quarter (which qualifies for the highest score A). Existing issues of inscribed stock can be re-opened to build the volume outstanding to around PGK 500 million. T-bill issuance volumes may be adjusted more frequently to accommodate

cash management needs. The calendar is published in market media and on the websites of Treasury and BPNG. FED also undertakes semi-annual consultations with market participants to discuss the government's financing program. Market participants report being satisfied with the predictability of the auction calendar and the information provided during the consultations.

T-bills are issued on Wednesdays, and inscribed stock on Tuesdays. The details of a T-bill auction are announced the day ahead, while those of an inscribed stock auction one week in advance. On auction day, the reception of bids begins at 9:00 am and closes two hours later. Bids are submitted by sealed envelope, or additionally by fax in the case of T-bills. Both T-bills and inscribed stock are auctioned under multiple-price format, and bidding is done on a yield basis. The minimum ticket is PGK 100,000, with multiples thereafter of PGK 10,000. Auctions are open to both registered bidders, largely commercial banks and other deposit-taking institutions, and non-registered bidders.[15] Commercial banks may submit bids for their own account and for clients.

All bids are reviewed by FED and the central bank for technical compliance with the auction rules. Bids are then ranked and delivered to FED for approval. The government may not accept more than the total announced volume of the auction, although it has some scope to re-allocate volumes across tenors. The government is allowed to exercise reserve-pricing and allocate less, although this does not occur often. The outcome of the auction is posted on the websites of the Treasury and BPNG. The published results include, by security, the total offer, total bid, and volume accepted, as well as the minimum, maximum, and weighted-average yields of accepted bids. Market participants report satisfaction with the speed of auction result announcements. Settlement for both T-bills and inscribed stock occurs on Friday.

Semi-annual consultations between FED and market participants represent good practice and should be continued as this provides the authorities with useful insights into fiscal policy design based on the willingness of investors to hold government debt.

Dimension 2: The Government has prepared prospectuses (*Information Memorandum for Inscribed Stocks* and the *Treasury Bills Terms and Conditions*), which are available to market participants and are published on the websites of Treasury and BPNG. These documents contain detailed information on how auctions are conducted and settlement of transactions in government securities is to be effected. Market participants report that sufficient information is available to understand the terms and conditions, borrowing procedures, and criteria for access to the primary market.

In light of the above, the requirements for "A" scores are met for both dimensions.

2.1.9 DPI-9 External Borrowing

Dimensions	Score
1. Degree of assessment of the most beneficial/cost-effective borrowing terms and conditions (lender or source of funds, currency, interest rate, and maturity)	D
2. Availability and quality of documented procedures for external borrowings	D
3. Availability and degree of involvement of legal advisors before signing of the loan contract	B

[15] Non-registered bidders are required to deliver payment for bids at the time they are placed, whereas registered bidders, having been pre-approved as credit-worthy by BPNG, deliver payment on settlement.

Dimension 1: The process underpinning the 2011 Budget by which development projects are identified for inclusion in the annual Development Budget begins with line ministries submitting proposed projects to the Department of National Planning and Monitoring (DNPM). DNPM then assesses the consistency of the proposed project with the *Medium-Term Development Plan (MTDP)*, the *Medium-Term Fiscal Plan* and the annual *Development Budget Strategy*. Financing for the MTDP is notionally divided into three components (government-financed, donor grants, and loans) and a total annual figure for external borrowing is contained in the annual Budget. However, to meet the minimum requirement for this dimension, an annual assessment is required of the most beneficial terms and conditions for external borrowing. While the Government's MTDS sets out the desirable characteristics of external borrowing, the annual borrowing plan does not explicitly assess the "all-in" cost of each form of external borrowing, including any complementary benefits offered by the lenders, such as grants and free technical assistance, nor does it assess the consistency with the external borrowing criteria contained in the MTDS. A clearer link to the MTDS would improve the assessment.

Projects for which external financing is required tend to have been identified in the context of medium-term strategies with individual donors (e.g., the Country Partnership Strategy with the World Bank or the PNG-Australia Partnership for Development), which themselves are expected to align with the PNG's development plans and priorities. While this process does not provide significant flexibility with respect to the selection of creditor for a specific externally financed project, scope does exist to influence some loan terms, including the currency in which a loan is denominated and the variability of the interest rates (e.g., ADB loans from ordinary capital resources).[16] However, the authorities were unaware of the range of options available and are not, therefore undertaking a regular assessment of the most beneficial and cost effective terms and conditions for external borrowing. For these reasons, the minimum requirement is not met.

Dimension 2: This dimension requires that documented procedures exist for all external borrowing by the central government, including the preparation of a term sheet by one of the officials involved in the negotiation of the loan, describing the terms of the loan within a reasonable period of time. The term sheet ensures that the terms of the loan are fully understood by officials entering the transaction data into the debt recording unit. Alternatively, direct input into the debt recording system of the loan by the staff member responsible for the loan negotiation and contracting which is then validated by back office staff, is acceptable practice.

In the case of FED, no written procedures exist for the contracting and processing of external loans, nor is there a clear separation between front office and back office staff. The latter shortcoming will likely be rectified with the successful implementation of the planned divisional restructuring. For the minimum requirement to be met, this new structure will need to be accompanied by the preparation of documented procedures that require the recording of the terms of each new loan within three weeks of the conclusion of the loan negotiation.

Dimension 3: This dimension assess the extent to which legal advisors are involved in the negotiating and contracting of each external loan. According to the Office of the State Solicitor, government lawyers are involved in assessing draft loan agreements with external creditors, participate during a substantial part of loan negotiations, and review final agreements.[17] This meets the requirements of the "B" score.

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[16] See, for example, *ADB Financial Products*, 2008, Asian Development Bank

[17] The State Solicitor had just come from participating in loan negotiations with the World Bank.

2.1.10 DPI-10 Loan Guarantees, On-lending, and Derivatives

Dimensions	Score
1. Availability and quality of documented policies and procedures for approval and issuance of central government loan guarantees	D
2. Availability and quality of documented policies and procedures for on-lending of borrowed funds	D
3. Availability of a debt management system with functionalities for handling derivatives, as well as availability and quality of documented procedures for the use of derivatives	N/R

Dimension 1: The authority to issue guarantees on behalf of the state is set out in the *Public Finances (Management) Act* which also requires the Minister to table the documents associated with the guarantee at the next sitting of Parliament following the granting of the guarantee.[18] Ministerial approval is also required for guarantees of medium- or long-term loans (i.e., longer than 6 months maturity) contracted by provincial or local-level governments.[19] While the Act gives the Minister the authority to charge a fee in respect of a guarantee, no such fee is required, nor is it clearly linked to the level of risk associated with the guarantee. No administration fee or risk premium was charged for the only guarantee issued by the central government in the last five years. There are no policies and procedures in place setting out the process for the approval and issuance of central government loan guarantees. The minimum requirement for this dimension is therefore not met.

Dimension 2: The authority to extend loans to public bodies on behalf of the State is set out in the *Public Finances (Management) Act*.[20] However, no policies and procedures for the approval and lending of borrowed funds are in place, although work is underway to prepare such a strategy which could be available as early as end-2010. An on-lending policy is clearly needed as on-lending arrangements continue to be put in place. Compliance with existing arrangements is poor, with only three debtors (out of more than 11 debtors plus various provincial governments) current in repaying loans from the central government. Among provincial governments, only one has ever made a payment and the last of these payments was received in 2003. Therefore, the minimum requirement under this dimension is not met.

Dimension 3: The PNG central government does not make use of derivatives. This dimension is therefore not rated.

2.1.11 DPI-11 Cash Flow Forecasting and Cash Balance Management

Dimensions	Score
1. Effectiveness of forecasting the aggregate level of cash balances in government bank account(s)	C
2. Effectiveness of managing the aggregate cash balance in government bank account(s), including the integration with the domestic debt borrowing program	C

[18] Article 37.

[19] Article 67, Section 3(c).

[20] Article 54.

Dimension 1*:* At the highest level, budget execution, including cash management, is governed by the *Public Finances (Management) Act*. Cash management is the operational responsibility of several units within Treasury and the Department of Finance, which in turn coordinate their activities and exchange information with BPNG. The primary mechanism to that end is the PDC, which meets weekly.

At the start of each fiscal year, an informal cash plan is prepared, presenting monthly forecasts of aggregate receipts, expenditures, and cash balances, based on inputs from FED, the Economic Policy Division, the Cash Management and Expenditure Control Division of the Department of Finance, and the Budget Division of Treasury. The plan is updated during the year. Notably, a formal forecast is prepared at the end of each month for the month to come, with a weekly granularity; it is reviewed by PDC to inform decision-making regarding T-bill issuance. An analysis of forecasts versus actual outturns is also carried out. To-date, forecasts have been sufficiently reliable for decision-making by PDC for cash management purposes, as well as by BPNG for its liquidity management operations.

The requirements for a score of C are met for the first dimension. A higher score is not possible; daily cash forecasts are not yet prepared on a weekly basis.

Dimension 2*:* Cash balance management is passive. The government's treasury single account, called the Waigani Public Account (WPA) is domiciled at BPNG. The government informally targets a floor of PGK 50-100 million for the balance in the WPA and, in the first instance, adjusts the weekly volume of T-bill issuance to accommodate anticipated mismatches in receipts and expenditures. Excess balances are not invested outside the WPA, such as in term deposits at the central bank or commercial banks. Under an agency agreement between the government and BPNG, a positive balance in the WPA is remunerated at a market-based rate. The rate paid by BPNG is equal to the average rate on call deposits at commercial banks during the previous week. Interest is calculated daily and paid monthly.

Apart from the WPA, there exists a body of accounts (trust funds) which are outside government cash management. These accounts represent public monies that were previously appropriated and have been placed in commercial bank deposits. Under current policy, they do not form part of the government's day-to-day cash balance to be managed. Measures are being introduced, however, to domicile all new trust funds at BPNG, although existing trust funds at commercial banks may continue to receive new inflows.

The requirements for a score of "C" are met. A higher score is not possible, owing to the absence of a formal target for optimizing the balance in the WPA and ensuring that excess balances are invested efficiently.

2.1.12 DPI-12 Debt Administration and Data Security

Dimensions	Score
1. Availability and quality of documented procedures for the processing of debt service	D
2. Availability and quality of documented procedures for debt data recording and validation, as well as storing of agreements and debt administration records	D
3. Availability and quality of documented procedures for controlling access to the central government debt recording/management system	D
4. Frequency and off-site, secure storage of debt recording/management system backups	D

Dimension 1*:* Processing debt service payments is the responsibility of FED. At the start of each month, the CS-DRMS unit prepares a system-generated schedule of payments to be made during the month. For external debt service, unit officers compare FED's records against payment requests received from creditors, and will follow up with creditors in the event that a payment request was not received.[21] If there is a difference between FED's calculation of debt service to be paid and that of the creditor, FED pays the amount advised by the creditor, unless the difference is substantial in which case FED will attempt to resolve the difference with the creditor. A unit officer prepares a paper payment order, which is verified for accuracy by another officer from the same unit. The order is then signed by the head of the unit and the head of FED, as well as countersigned by the Accounting Division in the Department of Finance, which confirms that an appropriation is in place for the payment. The payment is finally effected by BPNG on behalf of the government. Once the payment has been made, BPNG notifies FED, which in turn confirms its receipt by the creditor. Payments are made on time.

A different process is followed for domestic debt service. Each week, BPNG provides FED with a notice of upcoming interest payments and principal repayments. This is examined by unit officers within FED, signed off by FED management, and included in the cash flow information reviewed by PDC at its weekly meeting. The minute of PDC's meeting notes the amount of domestic debt service to be paid, and no countersignature by the Accounting Division of the Department of Finance is required.[22] BPNG effects the payment under a standing instruction and advises FED once it occurs.

Notwithstanding these good practices, the procedures for the payment of debt service have not been documented systematically or comprehensively. Consequently, the minimum requirements for the first dimension are not met.

Dimension 2*:* Data on new loans and securities, disbursements on existing loans, and debt service are entered in CS-DRMS by unit officers in FED, verified for accuracy by another officer from the same unit, and confirmed by the head of the unit.[23] The CS-DRMS unit also examines data entries for technical accuracy within the database environment. Data entries are kept up to date, in line with notices from creditors.

The original loan agreements are stored within FED's office space in ordinary filing cabinets. They are not secured against theft, fire, flood, or other incident that may cause them to be lost or destroyed, nor are photocopy or electronic backups of the loan agreements made. Other debt administration records, such as correspondence with creditors, are kept by the responsible unit within FED. These records are also not protected, and officials report that filing in some cases has become chaotic.

More generally, procedures for debt data administration and recording, as well as the storage of agreements and debt administration records, have not been documented systematically or comprehensively. Consequently, minimum requirements for the second dimension are not met.

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[21] FED reports that problems with timely receipt of payment requests are associated largely with certain bilateral creditors.

[22] While this framework is sound, the mission had concerns with the failure of the PDC to achieve a quorum at its weekly meetings.

[23] In some cases, new loans are entered into the debt recording system by the CS-DRMS unit and are then verified by FED managers.

Dimension 3*:* FED relies on vendor-supplied manuals for guidance on appropriate controls for access to CS-DRMS. In that spirit, for example, FED's practices include separate user accounts and passwords for each officer, periodic changes to passwords, and the generation of audit trails of system activity. However, FED has not supplemented the vendor manuals with its own procedures that formalize how it will implement that guidance or deviate from it. Consequently, the minimum requirements for the third dimension are not met.

Dimension 4*:* Partial backups of the CS-DRMS database are taken daily and full backups weekly, but are maintained within FED under arrangements that are not secure against damage or loss. FED has reached an agreement with BPNG for the central bank to store backups of the database, but this practice has not yet begun. Similarly, there are plans to replicate the CS-DRMS database at Treasury's off-site disaster-recovery facility, along with the department's other databases, but this also remains to be implemented The minimum requirements for the fourth dimension are not met.

2.1.13 DPI-13 Segregation of Duties, Staff Capacity, and Business Continuity

Dimensions	Score
1. Segregation of duties for some key functions, as well as the presence of a risk-monitoring and compliance function	D
2. Staff capacity and human resource management	C
3. Presence of an operational risk management plan, including business-continuity and disaster-disaster recovery arrangements	D

Dimension 1*:* Debt management activities in Papua New Guinea are largely centralized within one entity, FED. The internal working structure of FED is organized by creditor and market, with separate units for external debt (World Bank; Asian Development Bank; and commercial, bilateral, and other multilateral) and domestic debt, as well as a unit responsible for the debt recording system. Each unit is responsible for the full suite of activities associated with a particular creditor, including negotiating and contracting new borrowings, processing debt service, recording debt data, and preparing reports. Data entries into the debt recording system are finalized only after review by other staff members within the unit. Absent from the current working structure is an explicit risk monitoring and compliance function. To the extent that the function exists, it is carried out only sporadically by unit heads as a component of another exercise. In light of these considerations, the minimum requirements for the first dimension are not met.

A plan to restructure FED has been developed. The division would be restructured to have separate front and back offices, and a middle office would be introduced. FED would also take on some cash management responsibilities. If implemented, the new structure would be conducive to achieving better segregation of duties, and would have designated staff tasked with risk monitoring and compliance.

Dimension 2*:* FED has a complement of 25 staff. Staff members are sufficiently skilled to carry out the current functions of the division. However, there is a need to build capacity to analyze financing proposals and cost and risk characteristics of the debt portfolio. The number of staff should be adequate to carry out all core functions. However, some functions are neglected. For example, publication of a debt statistical bulletin was suspended a number of years ago. This is increasingly becoming an issue, as FED is called to take on further operational and

analytical responsibilities. There are plans to increase the staffing of FED as part of the planned restructuring.

Recruitment and retention of staff is complicated by increasing competition from BPNG, state-owned enterprises, and the private sector. Staff members have individual job descriptions, and performance evaluations occur at six-month intervals. New staff members are typically recent university graduates, who require additional training. Management recognizes the value of skills-building, and a comprehensive training plan is place for each staff member. A uniform code of conduct applies to all civil servants[24]; it is not currently supplemented to take into account the specific circumstances associated with FED in its relations with creditors and the market (e.g., there are no restrictions placed on the trading of government securities by FED staff).

The minimum requirements are met for this dimension.

Dimension 3***:*** No business-continuity and disaster-recovery plan is currently in place for FED's debt management operations, and awareness of this risk is generally low. Measures are in place to protect some the Department of Treasury's records, but debt management operations are not included in this effort. Consequently, the minimum requirements are not met for the third dimension.

2.1.14 DPI-14 Debt Records

Dimensions	Score
1. Completeness and timeliness of central government debt records	D
2. Complete and up-to-date records of all holders of government securities in a secure registry system	A

Dimension 1***:*** FED is responsible for maintaining records of stocks and flows associated with the direct and guaranteed debt of the central government. This is done through a combination of electronic and manual records. Data on direct domestic and external debt are recorded in the debt management database, CS-DRMS. The database also records loan guarantees issued in prior years. On lending arrangements have not been entered to-date in CS-DRMS. FED has records of those transactions, however, in manual form, and is able to generate reports for internal management use from them. The records are up-to-date within a one-month lag. FED, however, lacks proper documentation for the central government's counter guarantee related to the LNG project. As a result of this shortcoming with the counter guarantee, the minimum requirement for this dimension is not met. The otherwise sound practices in place for debt records would potentially merit a score of "A".

Dimension 2***:*** BPNG maintains the registry of T-bills, inscribed stock, and central bank bills. Commercial banks maintain accounts in the registry for their own book and also as nominee for end-investors; no periodic survey is undertaken to determine the composition of beneficial holders, however. The registry is a secure, controlled-access database, and its records are kept up-to-date. The secondary market in government securities is almost non-existent, so changes to the registry, beyond recording new issuance and redemptions, are infrequent. When a secondary market transaction occurs, changes in the registry are effected following receipt of

[24] Public Service Code of Business Ethics and Conduct, *Public Services (Management) Act (1995)*, June 2002

matching confirmations from the counterparties to the trade. Investors in securities may request statements of their holdings.

Records are secure. Back-ups are taken daily and stored outside Port Moresby. The registry is audited annually as part of the external audit of BPNG. No issues were raised in the audit concluded earlier this year. Similarly, market participants report no problems with the accuracy or security of the registry. The requirements for a score of "A" are met for this dimension.

2.1.15 DPI-15 Debt Reporting

Dimensions	Score
1. Meeting statutory and contractual reporting requirements of central government debt to all domestic and external entities	C
2. Meeting statutory and contractual reporting requirements for total nonfinancial public sector debt and loan guarantees to all domestic and external entities	D
3. Quality and timeliness of the publication of a debt statistical bulletin (or its equivalent) covering central government debt	D

Dimension 1: Statutory requirements for reporting on central government debt (both domestic and external) are contained in the *Fiscal Responsibility Act*, which requires the submission to Parliament and public release of a Final Budget Outcome document for each financial year no later than three months after the end of the financial year, including the following information:

- A summary of fiscal performance including net lending;
- A comparison and explanation of variations from the budget estimates for net lending;
- A summary of national government financing activities for the financial year; and
- A summary of the national government debt position with comparative figures from the previous year's figures.

The Government complies with this statutory requirement, and, for 2010, consistent with the minimum requirement for the first dimension, the Final Budget *Outcome Document* was made available on the Treasury's website on March 31, 2010–three months after the end of the financial year. To achieve a "B" score, the *Final Budget Outcome Document* would need to be published within two months of the end of the financial year.

The Minister is also required to submit to Parliament a copy of each external borrowing agreement "as soon as practicable" after the execution of the loan agreement.[25] In the case of loans from international agencies, the Minister is required to inform Parliament of the amount, purposes and sources of the borrowing, and the terms and conditions of the loan agreement as soon as practicable after the execution of the loan agreement.[26]

In addition, the World Bank requires the Government to report debt data to the Debtor Reporting System. PNG is in compliance with this requirement.

Dimension 2: The *Fiscal Responsibility Act,* which stipulates reporting requirements for government debt, does not apply to the *total* non-financial public sector, which consists of the

[25] *Loans (Overseas Borrowings) Act* (1973), Article 2, Section 4: The mission was unable to assess compliance with this requirement for each loan, partly due to the difficulty in assessing what is "practicable".

[26] *Loans and Assistance (International Agencies) Act* (1971), Article 2, Section 7.

central government (including budgetary, extra budgetary and social security funds), state and local governments, and non-financial public corporations. Consequently, the debt of the total non-financial public sector is not reported in the *Final Budget Outcome Document*. However, this dimension also requires reporting of loan guarantees for which the central government does have both a statutory reporting requirement (i.e., timely submission to Parliament) and a contractual requirement (i.e., reporting to the World Bank's Debtor Reporting System of all external borrowings on a loan by loan basis as long as they are guaranteed by the country). For the LNG guarantees, the statutory requirement was met; the contractual requirement was not. Therefore the minimum requirement for this dimension was not met.

Dimension 3: PNG has not published a statistical debt bulletin in more than five years.[27] Had earlier publications been continued, they would have likely met the minimum requirement under this dimension. The quarterly publication referred to above, for example, would likely have met the requirement for score of "A". Currently, a quarterly Management Report covering central government debt and containing most of the analysis required by this dimension is prepared by FED and circulated within Treasury. However, it is not published. Therefore, the minimum requirement for this dimension is not met.

[27] See, for example, *Public Debt Trends, First Quarter 2004* and Public *Debt Bulletin 2002,* both produced by FED.

Annex 1: List of Officials Interviewed

Name	Surname	Organization	Unit	Title
Kevin	Neuendorg	ANZ Bank	Markets Department	Head of Markets
Bora	Bedamu	ANZ Bank	Treasury department	Senior dealer
Delicia	Gawi	ANZ Bank	Global Markets	Senior Money Market Dealer
Kingsley	Anakapu	ANZ Bank	Institutional	Relationship manager
Frank	Gamble	ANZ Bank	Risk	Chief Risk officer
Charles T	Andrews	Asian Development Bank	PNG resident mission	Country director
Dominic	Mellor	Asian Development Bank	PNG resident mission	Country Economist
Gabriel	Koh	Auditor General's Office		Deputy Auditor General
Ketheeswaranathan	Mahendran	Auditor General's Office		Auditor
Robert	Harden	AusAID	Pacific & PNG Branch	Economic advisor
David	Osborne	AusAID		First Secretary
Andrew	Elborn	AusAID	Economic and Public Sector Governance	First Secretary
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Buil	Minig	Bank of Papua New Guinea	Financial Markets Unit	Manager
Winnie	Linken	Bank of Papua New Guinea	Financial Markets Unit	Senior analyst
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Timothy	Nauru	Bank of Papua New Guinea	Registry Unit	Manager
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Christopher	Beets	Bank South Pacific (BSP)	Treasury	GM
Mark	Corcoran	Bank South Pacific (BSP)		Country manager
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Jessie	Yore	Department of Finance	Internal Audit & Compliance	Assistant Secretary
Tom	Tiki	Department of Finance	Internal Audit & Compliance	Assistant Secretary
John	Polum	Department of Finance	ITD	Senior database officer

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Betty	Yakopya	Department of Justice	State Solicitors' Office	Senior Legal Officer
Jena	Kuliniasi	Department of Justice	State Solicitors' Office	Senior Legal Officer
George	Minijihau	Department of Justice	State Solicitors' Office	State Solicitor
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Floyd	Lala	Department of National Planning and Monitoring	Foreign Aid Division	Aid Coordinator
Lawrence	Duguman	Department of National Planning and Monitoring	Foreign Aid Division	Assistant Secretary, Bilateral Branch
Tony	Yedu	Department of National Planning and Monitoring	Public Investment Policy	Senior programme officer
Joanna	Kubak	Department of National Planning and Monitoring	Policy Branch	Senior policy officer
Juliana	Kubak	Department of National Planning and Monitoring	Policy Budget and Statistics Division	First Assistant Secretary
Casper	Auntari	Department of National Planning and Monitoring	Public Investment Program	Acting First Assistant Secretary
Gertrude	Kilepak	Department of National Planning and Monitoring	Policy Branch	Policy officer, sectoral
Elizabeth	Kup	Department of National Planning and Monitoring	Foreign Aid Division	Senior Aid coordinator, Multilateral Branch
Koney	Samuel	Department of National Planning and Monitoring	Foreign Aid Division	Assistant Secretary, Multilateral Branch
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Wilson	Ay-Yeung	Department of Treasury	Economic Policy Division	Strongim Gavman Advisor
Colin	Johnson	Department of Treasury	Economic Policy Division	Strongim Gavman Advisor
Jacob	Gop	Department of Treasury	Financial Evaluation Division	Assistant Secretary
Megan	Hardy	Department of Treasury	Financial Evaluation Division	Strongim Gavman Advisor
Earau	Iru	Department of Treasury	Financial Evaluation Division	Financial Analyst

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Herman	Pahau	Department of Treasury	Financial Evaluation Division	Financial Analyst
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Simon	Tosali	Department of Treasury		Secretary
Gibson	Gotaha	Department of Treasury	Financial Evaluation Division	Assistant Secretary, Domestic Branch
John	Uware	Department of Treasury	Financial Evaluation Division	Acting First Assistant Secretary
Damien	Horiambe	Department of Treasury	Financial Evaluation Division	Assistant Secretary, World Bank Branch
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Betty	Yakopya	Solicitor General's Office		Senior Legal Officer
Moses	Koiri	IPBC		Chief Operating Officer
Jayapal	Jayaraj	IPBC		Chief Financial Officer