# Investigation Task-Force Sweep (ITFS)

# SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS FOLLOWING INVESTIGATIONS INTO PAYMENTS OF COURT JUDGEMENT DEBTS AND LEGAL FEES

## 1 Executive Summary

As directed by the Prime Minister Hon Peter O'Neill, CMG through a Prime Ministerial Directive dated 13th May 2013, Investigation Task-Force Sweep (ITFS) has conducted an investigation into the allegations of fraudulent payments of legal fees and court orders by Department of Finance (DoF). Terms 6 and 7 of the Prime Ministerial Directive was for the identification of inadequacies in the internal controls and external supervision of the Department of Justice and Attorney General and Department of Finance and Treasury with a view to refine the processes of settling legal fees, out of court settlements and court judgements debts. This report summarises the findings and conclusions of the ITFS and sets forth its recommendations.

Gaps in the legislations, control weaknesses and lack of written contracts with precise terms amongst others had led to overbilling, increased legal costs and duplicative and unauthorized services being performed by lawyers and law firms in the provision of State Legal Services. The recommendations propose a policy reform to establish the principles and requirements associated with contracting for legal services by the State so that such contracting is conducted in a diligent and accountable manner and in accordance with the law. Developing such policies and procedures can help to reduce legal costs, ensure transparency and promote accountability. The policies and procedures should set forth, for example, specific processes for procuring outside counsel, requesting legal advice from outside counsel, authorizing outside counsel to perform specific legal services and monitoring legal spending.

## 2 State Legal Services

### Findings

The Department of Justice and Attorney General is a central government agency responsible for the provision of legal services to the State and its agencies. The Office of the State Solicitor and the Office of the Solicitor General are two principal government law offices within the department that provide State Legal Services. The Solicitor General is appointed by the Attorney General. Upon the Attorney General's instructions, the Solicitor General and his/her team of lawyers within the Office of the Solicitor General have the primary responsibility of advocating for and on behalf of the State, particularly in civil claims/suits that are made by and against the State.

According to the Law as it is, the State Solicitor's appointment is not clearly established by law. There is no legal basis for the State Solicitor to report to the Attorney General. The State Solicitor's Office is regarded as a branch of the Department of Justice and Attorney General as one of various constitutional and legal offices which provide varying legal services including advice and legal representations for various clients in particular the State. The branch is required under various Acts of Parliament including the Public Finances (Management) Act, 1995, Public Services (Management) Act, 1995 and the National Executive Council's Handbook on Submissions, to provide legal opinion and it issues letters of legal clearance before the State makes commitment in the conduct of State business.

Under section 8 of the Attorney General Act 1989, the Attorney General also provides legal advice and opinion on matters affecting the conduct of the business of the State where legal issues arise or might arise to the exclusion of all other lawyers unless he authorises other persons to do so.

Although most of the State Legal Services are provided by the Office of the Solicitor General and Office of the State Solicitor, on occasions, however, the Department of Justice and Attorney General also relies on private sector law firms and lawyers, appointed as Legal Agents, to assist with the delivery of legal services. Legal Agents provide legal services upon a brief out from the Attorney General.

The Solicitor General's Office in particular used to be seriously under-resourced and does not have its office branches in many centres of the country. This has resulted in high rate of court judgements entered against the State and consequently millions of kina were paid out to claimants and litigants. Instead of improving the Solicitor General's office, its inefficiency and incompetence in defending the State was used as an excuse to brief cases out to private lawyers and law firms indiscriminately including those matters that were simple and straight forward and could have been handled by State Lawyers.

### Conclusions

The manner in which the legal services are delivered to the State is deficient in multiple ways including structural, legislative and capability issues. Apart from the Solicitor General, the office and role of State Solicitor is not clearly established by law hence the ambiguity can potentially create confusion with the role of the Attorney General. There is a need for the State Solicitor's Office to be crafted into the Attorney General Act with express provisions for appointment, functions and reporting. That includes defining the State Solicitor's role in light of the Attorney General's powers under section 8(4) of the Attorney General Act.

The Offices of the Solicitor General and State Solicitor can provide competitive legal services to the State if adequately resourced. The benefits of equipping the two offices would far outweigh the cost thereof.

### Recommendations (1)

**The *Attorney General Act 1989* should be amended to:**

a) **Create the Office of the State Solicitor similar to that of the Solicitor General under the Act.**

b) **Define the responsibilities of the State Solicitor with clear reporting lines between the State Solicitor and the Attorney General.**

c) **Considerations should be given to measures which would strengthen the Government law offices' professional capabilities and resources. The Offices of the Solicitor General and State Solicitor have to be transformed to provide high-quality, effective and efficient legal services to the State. Better still and in the long term, the Government should corporatize the two offices to improve their efficiency in the provision of legal services to the State just like a private law firm. The Australian Government Solicitor (AGS) is one of those models that can be considered.**

## 3 Attorney General's Authority to Contract State Legal Services

### Findings

Pursuant to sections 7(i) and 8 (4) of the Attorney General Act 1989, the Attorney General is the only person authorised to contract with private lawyers and law firms to act for the State in civil litigation and legal advisory matters for and on behalf of the State. It is a basic principle of the administration of justice and of a proper lawyer/client relationship that lawyers act only on instructions of their clients. For all the agencies of the government that come within the term "State", instructions must come from the Attorney General. The Attorney General Act does not define the term "State".

A number of private lawyers and law firms purport to act for the State without any brief-out from the Attorney General. In other occurrences, lawyers claimed to have been briefed out by the Solicitor General.

### Conclusions

It is the absolute discretion of the Attorney General to outsource State Legal Services for and on behalf of the State. Any legal services carried out on behalf of the State by private lawyers and law firms without the approval of the Attorney General are in excess of authority and thus illegal. The Attorney General Act however does not define the scope of the term "State" as it appears in the Attorney General Act.

### Recommendation (2)

**The *Attorney General Act 1989* should be amended to define the term "State" as it appears in the Act. That the definition of the term "State" should be consistent to the *Claims By And Against the State Act 1996* insofar as the term is used there and as is interpreted by the Supreme Court in *Reservation Pursuant to Section 15 Supreme Court Act* [2001] PGSC 8; SC672 SCR No1 of 1998.**

## 4 Are Brief-Outs Subject to Public Tender?

### Findings

Section 209 of the Constitution in mandatory terms requires all expenditure of public funds to be authorised by Parliament. Section 211 of the Constitution renders it illegal for any expenditure of public funds that is not authorised by Parliament through the Appropriation Act. Expenditure of public funds is regulated by the PFMA. Unless exempted by law, all procurement of goods and services above a certain prescribed amount must be publicly tendered. Two dominant features that attract the application of the PFMA are: (1) if it involves public funds; and (2) if the body administering the funds is an agency of the State, a public body.

The Attorney General Act itself does not provide an elaborate procedure on how legal services can be outsourced without offending the requirements of tender under the PFMA. The National Court declared in a particular case that legal services procured by certain government bodies without complying with the PFMA such as tender and ministerial approvals are illegal, null and void and therefore unenforceable.

Investigations reveal that contracts for the performance of legal services entered into, by, or under the authority of the Attorney General have never been subjected to the requirements of public tender under the PFMA. In certain other instances, Government departments contract legal services from the private sector on retainer basis without public tender. The bills are at times structured and layered to avoid the mandatory procurement obligations as well as financial limits imposed by the PFMA.

### Conclusions

The Attorney-General Act though is not expressly synchronised with the PFMA on procurement of State Legal Services, the funds paid to private lawyers are public funds and the entities administering them are public bodies for the purposes of the PFMA. Ambiguities in the law have been partially responsible for some, not all, of the non-observance of the tender requirements. Although legal services had never been publicly tendered in the past, procurement of legal services and payment of legal fees had become a subject of recurred controversy. A clear legislative scheme has to be established to harmonize the Attorney General Act 1989 with the PFMA in order to subjecting State Legal Services to public tender.

The rationale behind public tender is to prevent fraud, wastage and corruption; hence the Government has to regulate the procurement process of State Legal Services. Legal Services is a specialized area and a specialized tender board should be established. As a specialized professional service and in most cases the need for legal services is usually unpredictable, protracted public advertisements requirements should be exempted. However, in certain circumstances, there is need for competition, transparency, and accountability in the award of such contracts in order to promote public confidence in the contracting process and to ensure that government entities are obtaining cost-effective services.

ITFS found no evidence suggesting that the Attorney General maintains a register of private lawyers and law firms specialising in different areas of law. Although such is not a requirement of law, it is prudent to have such a register so that specific cases are given to lawyers and law firms that have expertise in that particular area of law.

### Recommendations (3)

a) **The Attorney-General Act 1989 and the Claims By and Against the State Act 1996 should be amended to conform to the Constitution, Public Finances (Management) Act 1995 and the Appropriation Act insofar as procurement of legal services is concerned. A decision making process must be clearly defined and established where the Attorney General brief-out legal work to private law firms within the appropriate legal framework without offending the requirements for public tender under the PFMA.**

b) **Consistent with recommendation 3 (a) above, the Minister for Finance establish, by way of notice in the National Gazette, a specialised tenders board for State Legal Services under section 39A(1)(a) of the PFMA to be comprised of officers of DJAG and**

any others deemed appropriate. That board would consider the need to brief out, whom to brief out and on what terms before advising the Attorney General to execute the brief-out.

c) Consistent with recommendations 3 (a) and (b) above, the Minister for Finance make appropriate rules under section 39A(2) of the PFMA prescribing the procedures and processes of tendering State Legal Services. Because of the uniqueness of the legal services as a specialised professional service, some flexibility can also be accorded in the rules including exemption from public advertisement requirements unless special circumstances such as the services are substantial in nature like drafting multiple legislations.

d) In addition to recommendation 3(c) above, the rules should cater for all lawyers and law firms to furnish to the State their profiles containing their capacity to undertake State Legal Services and the fee structures they would agree to. The special tender board should maintain a panel of providers of legal services including their areas of specialty.

## 5 Decision to Outsource State Legal Services

### Findings

Since the DJAG already has the Offices of the Solicitor General and State Solicitor reserving the primary role of providing legal services to the State, briefing out to private lawyers and law firms is an exception. The Attorney General Act 1989 however does not specify the circumstances under which State Legal Services can be outsourced. The Attorney General therefore has an unfettered discretion to brief-out any lawyer or law firm of his choice at any time. Briefing out to cronies and outsourcing relatively simple straight forward matters that could be handled by State lawyers are among the few instances uncovered in the investigation. In some instances, the costs incurred by private law firms to defend certain claims were higher than the actual claims.

### Conclusions

There is a need to establish the principles and requirements associated with contracting for State legal services by the Attorney General so that such contracting is conducted in a diligent and accountable manner.

### Recommendations (4)

The rules promulgated by the Minister for Finance as recommended under 3(c) hereinabove should make provision for the following principles and requirements as considerations for outsourcing State Legal Services:-

- capacity within the Department of Justice and Attorney General
- timelines and level of urgency
- level and impact of risk assessment
- experience and expertise requirements
- geographic and jurisdiction considerations
- security considerations
- conflict of interest considerations
- public interest considerations; and
- unique considerations associated with the work.

## 6 Terms of the Contract for State Legal Services

### Findings

Sections 7(i) and 8(4) of the Attorney General Act are clear that the Attorney General can brief out any matter (single matter) at a particular time. In order to constitute a valid contract there must be certainty of terms and price (valuable consideration). All contracts for government works, supplies and provision of services relate to specific projects/service, price and time limitations and are within the confines of the annual budgetary allocations.

The investigation uncovered instances where legal brief-outs were done in bulk without having recourse to the annual budgetary appropriations under the Appropriation Act and tender requirements under the PFMA. Payments of legal fees ran into millions of kina based on a single brief-out letter. In certain instances, the cost of defending a particular matter would be relatively higher than the actual claim itself. Yet on other occasions, simple matters continued to be dragged on, spanning over a number of years. Contractual relationship between the State and the briefed out legal firms are rarely established on certain terms so as to ensure that the interests of the State in the contractual relationship is protected.

Apart from conveyancing matters, there is no statutory provision spelling out standard charge-out rates for lawyers and law firms when it comes to billing their clients. The billing structure may be fixed/capped, value billing or hourly rates. Whatever the fee agreement, it is best left to the lawyer and the client to agree to the terms of the engagement. Owing to its own inefficiencies and lack of prudence, the State had been paying exorbitant legal fees of private lawyers and law firms. To compound the problem, the Attorney General does not maintain a standardized schedule of charge-out rates nor impose such rates on lawyers and legal firms who are briefed out to undertake State legal services.

### Conclusions

A written contract for State Legal Services with certainty of price, time and the scope of services to be provided will protect the interests of the State. Bulky and blanket brief-outs (contracts) of legal services are likened to an open cheque hence are forbidden by law. Similarly, retainer brief outs are illegal. It is also contrary to sound fiscal policy to give an open ended brief out to a private lawyer or legal firm that extends the State's expenditure obligations into millions of kina without recourse to the annual budget, let alone the need for public tender. Brief outs should be done on a case by case basis. Furthermore, one of the most effective ways to prevent abusive or fraudulent legal billing practices is to use a clearly defined and unambiguous legal services contract.

### Recommendations (5)

a) The rules made under recommendation three (3) (c) should specify conditions of brief out agreement and as much as possible have them written into every contract for State Legal Services where appropriate. Conditions such as:-
   - The amount of time & labour required,
   - The novelty or difficulty of the issues raised,
   - The scope of work to be performed by the lawyer/law firm and any objectives or deliverables to be achieved,
   - The skills required to perform the legal services,
   - The acceptance of the case and whether it would preclude the lawyer from taking other cases,
   - The end result of the case,
   - Time limitations imposed by the client department or by the circumstances,
   - Professional relationship with the client, including past dealings or history with the client,
   - Experience,
   - Reputation and/or the ability of the lawyer(s),
   - Type of fee agreement; fixed vs. contingent.
   - Charge-out rate dependant on the fee agreement
   - Etc...

b) A standard legal services contractual agreement should be adopted whereby the conditions stated in recommendation four (4) (a) hereinabove are reflected. A sample standard contract is attached herein as Appendix (R1).

c) The State should adopt a fee structure for outsourced State Legal Services consistent with its fiscal and public expenditure policy.

## 7 Management of Legal Brief-Outs

### Findings

All brief-out matters under section 7(i) of the Attorney General Act are managed by the Solicitor General on behalf of the Attorney General. All files registered with the Solicitor General including brief out files are identified by a unique file reference number. All lawyers and claimants are advised to quote that file reference number for all purposes of corresponding with the State. The Solicitor General assigns one of his lawyers within the Office of the Solicitor General to manage a particular brief-out matter. The Office of the Solicitor General maintains a running file of all brief-out matters. The Solicitor General's Office has an electronic Case Management System (CMS) that records all events concerning a particular matter. When legal bills/invoices are submitted for verification and payment, the action officer at the Solicitor General's office assists the Solicitor General to vet the bills. If the Solicitor General is satisfied with the vetting, he then subject to his financial limit raises the requisitions for payment.

It was uncovered that the Solicitor General was avoided by lawyers and legal firms. The Solicitor General does not have files on certain matters that lawyers and legal firms claimed to have been briefed out to them. In certain other instances, there were no Solicitor General's file reference numbers and no evidence of brief outs.

### Conclusions

The State has to actively monitor the performance of the brief out contract in order to ensure that the contracted legal service provider performs the service in accordance with the terms of the engagement. That is to ensure the delivery of a cost effective and reliable service at an agreed price and standard.

The vetting of legal bills by the Solicitor General is there to prevent lawyers from unjust enrichment and fraudulent payments.

### Recommendations (6)

a) The proposed amendment to the Attorney General Act 1989 and new Financial Instructions recommended under 7(a) herein should also provide that:-
   - All civil litigation matters briefed out by the Attorney General under section 7(i) of the Attorney General Act 1989 to be managed by the Solicitor General; and
   - All legal advice procured by the Attorney General from external lawyers and law firms under section 8(4) of the Attorney General Act 1989 have to be managed by the State Solicitor.
   - The bills concerning the respective contracts have to be vetted and cleared by the respective management offices for settlement.

b) A Chart demonstrating the process of Brief Outs and Payments is enclosed herein and marked as "R2".

## 8 Clearance for Payment of Court Judgement Debts

### Findings

Funding for settlement of Court judgments debts and out of court settlements are appropriated under Division 207 (Miscellaneous) within the Department of Finance and Treasury. On the other hand, legal fees for brief-outs are appropriated under the DJAG.

An understanding had been reached between the Department of Finance and the Office of the Solicitor General followed by written correspondences detailing the process for the settlement of court orders/judgments etc. The process of settlement follows an agreed and well established payment process jointly administered by the Office of the Solicitor General and Expenditure Control Division of the Department of Finance. The Solicitor General retains running files of all State litigation matters and ensures that a particular matter has reached its finality and the State is obliged to pay a claimant/litigant before exercising his power under section 14 of the CBASA to endorse a certificate of judgment.

The Solicitor General assesses the judgment debt including the computation of interests, raises the requisitions and forwards them in a batch with a unique batch number to the Department of Finance for payment. The total monetary value of the batch depends on the size of the warrant released by Department of Treasury. The matters cleared for payment are prioritized according to their established principles such as the age of judgment, the costs of delayed settlement in terms of interests accruing etc.

A number of payments had been made by the Department of Finance without the requisite clearance from the Solicitor General. In one instance, exorbitant interests on a judgment were paid by Department of Finance to a claimant without the clearance from the Solicitor General. Investigations uncovered that the claimant was owed only a tiny portion of the millions he obtained purportedly as outstanding interests on judgment. In a number of other occurrences, payments were made based on National Court orders that were superseded by Supreme Court Orders. In other instances, age old clearance letters purportedly procured more than five years ago were presented to support a claim for payment.

### Conclusions

The Solicitor General is the lawful authority to qualify the settlement of a particular claim/matter hence all payments of and associated with civil litigation matters require the clearance from the Solicitor General. That is a fraud prevention mechanism to prevent payments based on false court documents such as false court orders. That is also to prevent payments made prematurely when the actual proceeding is challengeable or ongoing. Despite the established processes, payments are continuously being made by Department of Finance without the mandatory clearance from the Solicitor General. The established processes in settling court judgment debts and legal fees do not have the force of law. Given the prevalence of the abuses, the established processes and systems have to be increased in their statuses to have the force of law so that those processes can be enforceable.

### Recommendations (7)

c) The Secretary for Finance should promulgate the established systems and processes of settlement of court judgment debts and legal fees into appropriate Financial Instructions under section 117 of the PFMA to better control and manage payments of same.

d) Penal provisions should also be provided in the Financial Instructions to discipline (administratively, civilly and criminally) those who abuse the systems.

e) The clearance by the Solicitor General should take the format of a certificate (Certificate of Clearance for Payment), accompanied by other supporting documents such as copies of the Originating Process, Court Order and Certificate of Judgment.

f) In the proposed Financial Instructions under 7(a) herein, it should be provisioned that all clearances for payment must be fresh, corresponding with the warrant released by the Department of Treasury. If the warrant is exhausted and a cleared matter is not settled, the Solicitor General must be advised and a fresh clearance must be issued.

g) A Chart demonstrating the process of settlement of Court Judgment Debts is enclosed herein and marked as "R3".

## 9 Payment of Legal Fees, Court Judgments etc

### Findings

When Parliament, by way of an Appropriation Act, approves the expenditure of public funds as budgeted, funds are to be drawn out of legally appropriated votes for particular items. Pursuant to Section 31 of the PFMA, no public moneys shall be committed or expended except as authorized by a warrant authority within a financial year. The only exception is when using a trust fund. Warrants are issued based on the availability of the funds under that particular vote.

In circumstances where a particular vote is exhausted, there are limited options to source funding within a fiscal year. The first option is to adjust the appropriations between services. The second option is through the Secretary Advance which is a limited allocation for unforeseen pressing financial expenditure needs. And finally, revert back to Parliament for approval.

As a consequence of the Commission of Inquiry into Department of Finance in 2008 which exposed the gross abuse of Cash Adjustments and Suspense Accounts to settle court orders and legal bills, those facilities are never used again by the Department of Finance. The Trust Branch of the Accounting Framework and Standard Division of Department of Finance is responsible for the management of trust accounts, which is a non-bank account.

The Department of Finance has introduced a new finance system called Integrated Financial Management System (IFMS) since 2011. It is used for planning, budgeting, accounting and financial reporting to improve controls and support accountabilities to comply with the requirements of the PFMA. It is understood that this system was designed to capture all the required information and approvals before processing a particular payment but it is believed the IFMS is still a work in progress.

Court Judgements debts and out of court settlements are parked with the Department of Finance and Treasury under vote 207, Miscellaneous Program Payments (General Multi-Departmental). The Activity Code is 20743013101 (Court Cases). Funds are usually drawn based on the clearance letter from the Solicitor General. A number of payments had been drawn from that vote without the clearance from the Solicitor General. It has been found that when the court order/judgment vote was exhausted by August 2012, payments were directed and sourced out of reserve trust accounts. Payments were made by Department of Finance without the requisite warrant authorities with the hope of backfilling once the warrants were released by Department of Treasury.

Some of the payments were legal bills yet were categorised as "court order" payments when processed out of vote 207. It is also understood that the annual allocation for legal fees vote held at DJAG is small hence payments were drawn out from a bigger purse at the Department of Finance.

Although millions of kina were paid out, the documents and payment vouchers detailing the reasons for the payments are conveniently missing or insufficient. Department of Finance does not seem to take a serious approach in the maintenance of its records keeping.

### Conclusions

It is a breach of the Constitution, PFMA and the Appropriation Act to draw funds from a budgetary vote appropriated for other purposes. Funds have been illegally drawn to pay court judgement debts and legal fees. Legal fees had been camouflaged as court orders to enable the use of the court judgement vote at Department of Finance instead of being paid out of DJAG. Several knowledgeable witnesses have pointed out that the use of reserve trust account and payments made without the requisite warrant authority was totally improper and illegal. The abuse of trust non-bank accounts to pay unbudgeted expenditures by Department of Finance is recurring and must be permanently stopped or abolished.

### Recommendations (8)

The internal controls of the Department of Finance and Treasury including the IFMS should be reviewed with a view to tailor the system to reject payments that are not supported by fresh legal clearances. The systems should also be designed to reject payments drawn from reserve trust accounts and payments without warrants authorities.

## 10 Legal Bills

### Findings

According to section 62(2) of the Lawyers Act 1986 and Order 22 rule 49 of the National Court Rules 1983, all legal bills should contain particulars such as the work done by the lawyer, his servants and agents; the disbursements made; and the costs claimed for the work done amongst others. Despite the expressed provisions of the law, private lawyers and law firms submitted and received payments on bills that were not particularised. To further isolate the bills from being scrutinised, the bills were submitted directly to Department of Finance instead of through the Office of the Solicitor General. Department of Finance does not have the legal mandate and capacity to vet legal bills.

The investigation uncovered some of the egregious instances of double billing, padding hours, billing on matters not contracted/briefed out, claiming payment on work not done, bills with overlapping billing periods etc. Claims of legal fees containing block billings were also submitted for payment.

### Conclusions

A detailed analysis of the facts has convinced the investigation team that the great majority of the legal bills submitted directly to Department of Finance were bogus thus the judicious vetting process by Solicitor General was avoided. The State was left guessing the particulars of its obligations to pay. Block billing obscures the amount of time spent on each particular task, precluding State from determining whether the time billed was reasonable. Individualized, separate billing entries add transparency to legal bills and enable the State to avoid payment for improperly billed tasks.

### Recommendations (9)

The proposed Financial Instructions issued by the Secretary for Finance under 7(a) herein should, consistent with the Lawyers Act 1986 and the National Court Rules 1983, make it mandatory that all legal bills for lawyers briefed-out to undertake State Legal Services should be sufficiently particularized. All block billings should be outlawed.

## 11 External Oversight of Legal Clearances and Payments

### Findings

The investigation did not find existence of an external oversight arrangement to review the decisions of the State Solicitor and Solicitor General. The Solicitor General is subject to supervision by the Attorney General as the former receives instructions from the latter to perform his functions. However, the Solicitor General has not received a detailed scrutiny by the Attorney General. The Attorney General (if he is also the Minister) who is most of the time busy with his other commitments, rarely scrutinises the functions of the Solicitor General. The Office of the Secretary for Justice is responsible for administration purposes only and has no statutory authority to oversee the State Solicitor and Solicitor General so as to determine whether their activities are proper.

ITFS did find several instances where the Solicitor General issued clearance letters to the Department of Finance for payment without actually vetting the bills. Had the legal bills been properly vetted, clearance would not have occurred as the bills were irregular and bogus. There were also occasions where Department of Finance made the payments directly without the knowledge of and clearance from the Solicitor General. There were no reconciliations done on how much actually was paid by DJAG, how much was paid by Department of Finance and the amount outstanding. The State was dragged into an unending payment cycle.

### Conclusions

Whilst the State Solicitor and Solicitor General are allowed to freely perform their mandated functions, some form of oversight is helpful to prevent any abuse. The Solicitor General abused his authority by clearing bogus bills for payments. Lack of reconciliation has led to gross overpayments and fraud. The decision to issue legal clearances for payment must be periodically reviewed by an external oversight committee. Payments made by Department of Finance out of the Court Judgement Debts vote must be reconciled with the legal clearances issued by the Solicitor General. Similarly payments of legal fees must be reviewed to ensure that the value of the bills commensurate the services rendered.

### Recommendation (10)

An external Oversight Committee (eg Audit/Review Committee) should be established to conduct periodic review of all payments of legal bills, issuance of legal clearances and payments of court judgement debts. The composition of the Committee should include a lawyer and an auditor.

## 12 Curtailing Money Laundering

### 12.1 Lawyers and Money Laundering

### Findings

Private Lawyers and Law firms operate trust accounts for the purposes of holding money in trust for and on behalf of their clients. The Lawyers (Trust Accounts) Regulation 1990 regulates the use of the Lawyers Trust Accounts. Under the Regulation, private practising Lawyers are required to submit to the Law Society Council their annual financial reports on the use of their trust accounts. The Regulation demands that the accounts be prepared by an accountant. Part VII of the Lawyers Act provide for the Law Society to appoint an inspector to inspect the books of a Lawyer's trust account and report to the Council of his findings. The Council can then refer the report to the Lawyers Statutory Committee for further actions. The investigation did not establish how effective the Council uses these statutory provisions to scrutinise the operations of lawyers trust accounts.

Lawyers often claim that whatever amount that is deposited in the trust accounts and the instructions by their client on the disbursement of those funds are all covered by solicitor/client privilege. Whilst that is acceptable, there are lawyers who exploit the privileges to facilitate illicit transactions and conceal crimes.

Lawyers who have had no history of acting for a particular client in any matter appear on a payday as agents to receive payments on behalf of a client. On the face of it, it appeared that lawyers were used as debt collectors. However, following the money trail, it became so evident that a number of law firms trust accounts were used as conduits to obtain fraudulent funds and launder them.

On another case under investigation, a particular law firm's trust account was used as a Government project account to facilitate a government sanctioned project. No trust instrument was issued by the Minister for Finance and Treasury under the PFMA for the use of that trust account to receive and expend public funds.

On one other occasion, a particular law firm presented a cheque worth K1.5million with a supporting court order to a particular commercial bank. The commercial bank flagged the transaction as suspicious and ensuing investigations reveal that the Court Order was a fake one.

It is understood that lawyers trust accounts are also being used to receive illicit funds for investment purposes on behalf of their clients such as purchasing of real estate property.

The legal profession comes under a category of professions identified to have been used for money laundering purposes. They are called Designated Non-Financial Businesses and Professions (DNFBP) which are entities and professions that provide designated services as defined by POCA. DNFBPs are consistently targeted by criminals for criminal influence and criminal exploitation. Part of the recommendations of the Financial Action Task Force (FATF) is to impose reporting obligations on lawyers under the respective national ant-money laundering (AML) legislations. PNG is a member of the FATF and has its ALM regime under the POCA. The POCA does include the legal profession and other DNFBPs as "cash dealers". The FIU is however yet to establish the implementation mechanisms to effectively subject DNFBPs to the reporting requirements under POCA.

### Conclusions

ITFS has noted a decline in the established traditions and canons of professional ethics of lawyering in this country. As a result of the marked increase in lawyers' misconduct and the failure of the Law Society Council to discipline violations, the standing of the legal profession has been brought to disrepute by actions of a few lawyers.

Law firms trust accounts are increasingly becoming instruments of money laundering. Lawyer's trust account, which was conceived as the beacon of unblemished lawyering integrity, is becoming the vehicle of squalid criminality. The ease with which law firms trust accounts are being used to launder proceeds of crime demands tougher measures to subject their activities to enhanced scrutiny. Solicitor/client professional privilege and confidentiality must not prevent the need to subject lawyers to the reporting requirements under POCA.

### Recommendations (11)

a) Designated Non-Financial Business Professions (DNFBP) such as lawyers and law firms should be subjected to the cash dealers reporting requirements under the POCA. The Minister for Justice and Attorney General should request the FIU through the Minister for Police to implement the law on DNFBPs.

b) The Law Society Council should lift its efforts in scrutinizing lawyers trust accounts through the reports submitted to them annually with a view to taking disciplinary actions against misconducting lawyers. The Attorney General should write to the President of the PNG Law Society of these findings and recommendation.

### 12.2 Financial Institutions and Money Laundering

### Findings

The POCA places an onerous responsibility on cash dealers such as financial institutions to detect and report suspicious transactions. Only the commercial banks have working AML divisions and are filing Suspicious Transaction Reports (STRs) with the FIU. Other intermediaries and finance companies are yet to have such systems in place and/or comply with the POCA reporting requirements. The FIU issued Guidelines on 2nd June 2011 for the banks to be guided in the conduct of their due diligence. Pursuant to those Guidelines, the banks are required to establish the legitimacy of government payments prior to clearance. In most cases, banks demand supporting documents such as contracts etc.

Although the POCA requires cash dealers to report suspicious transactions to FIU, there is no explicit provisions in the POCA

for the cash dealers to reject the transactions that they believe are suspicious. Section 34 of POCA extends the definition of the offence of money laundering to include those transactions that the cash dealer ought to have known on reasonable grounds that they were proceeds of a crime. A few banks have rejected suspicious transactions and even closed bank accounts of those customers they view as high risk customers.

Suspicious transactions relating to purported court judgement debts and legal fees payments were found to have been conducted without sufficient due diligence. Some banks placed reliance on National Court orders without inquiring further whether there were overruling Supreme Court Orders. Transactions were allowed to be cleared and processed based on National Court orders although there were no Certificates of Judgements duly endorsed by the Solicitor General. Where a transaction relates to payment of legal fees, the banks failed to establish the legal contract which is usually a brief-out letter from the Attorney General.

Third party transactions were conducted between lawyers' trust accounts without any ostensible basis validating such transactions. Such a trend appears to have been practised for quite some time that it evolved into an understanding between banks and their lawyer clients for a number of years.

Lawyers have also been allowed to make substantial cash withdrawals out of their firm's bank accounts after government cheques were deposited and cleared. Those who wish to disguise paper trace for bribes increasingly prefer the use of cash. Unlike banks, lawyering is not a service that involves the use of substantial cash on a daily basis. There is no statutory limitation on cash withdrawals.

### Conclusions

Banks play a key role in the fight against fraud and money laundering, for no financial transaction is possible without the banks. Banks need to conduct an appropriate level of due diligence inorder to detect suspicious transactions. What has been missing however is that there is no standard guidance on the boxes that need to be ticked when conducting due diligence on a transaction relating to court judgements and legal fees, particularly those that involve the State.

The duty imposed on banks to avoid engaging in money laundering should not be limited to just ticking the boxes or submitting periodic transaction reports and STRs, but also taking proactive steps including rejecting transactions and closing bank accounts. Knowing Your Customer (KYC) is an integral part of the banks Customer Due Diligence (CDD) process hence banks should know their customers' pattern of transactions and take appropriate measures to avoid or mitigate the risks. The POCA should clearly make provision for such measures.

Unlike banks, Lawyering is not a service that involves the use of substantial cash hence those private law firms whose transaction patterns demonstrate large cash withdrawals should be treated as suspicious.

### Recommendations (12)

a) The FIU should issue supplementary guidelines under section 14 (c) of POCA to guide the cash dealers such as financial institutions to conduct due diligence on transactions relating to court judgment and legal fees payments. The Attorney General should write to the FIU through the Minister for Police to implement this recommendation. A sample Supplementary Due Diligence Guidelines is attached as "Appendix R4"

b) The POCA should be reviewed with a view to remedying some of the weaknesses identified in this investigation.

## 12.3 Bank of Papua New Guinea and Money Laundering

### Findings

The Central Bank or Bank of Papua New Guinea as is sometimes called (BPNG), apart from being the regulator of the Banks and financial institutions under the Banks and Financial Institutions Act 2000, is also the banker and financial agent of the Government pursuant to Section 8 (1) (b) of the Central Banking Act 2000. Investigations reveal that BPNG does not have an AML division with personnel adequately equipped to deal with money laundering issues.

Some of the cheque payments by Department of Finance relating to court judgements and legal fees were cleared by BPNG. There is no evidence suggesting that BPNG conducted due diligence on those transactions before remitting the funds to the accounts of the ultimate recipients' bank accounts held in the commercial banks. It was confirmed that BPNG's extent of inquiry is as far as calling the signatories on the cheque to confirm the transactions. BPNG officials confirmed to ITFS that they never ask for further documents to establish the legitimacy of the payments.

Pursuant to the recently enacted legislation called the National Payment System Act 2013, BPNG has initiated a new payment system called Kina Automated Transfer System (KATS) which came into operation in October 2013. KATS is an interbank payment system where transactions are electronically wired from bank to bank. Under that initiative, there has been the reduction in clearing for cheque payments; the introduction of a Real Gross Time Settlement system (first phase) and a cheque truncation (second phase) regime. The BPNG is a participant and user of the KATS.

Officers of BPNG advised that an AML module has been developed but yet to be implemented. The final KATS Rules dated 9th October 2013 makes no reference of an AML module nor does it indicate the application of POCA. BPNG has just rolled out the second phase of KATS on 8th September 2014

The point of receipt of physical cheque is the point of due diligence. The funds that are electronically remitted to other commercial banks using the KAT system are rarely subjected to further due diligence by the recipient bank as the recipient bank does not have the same opportunity as the remitting bank hence reliance is placed on the remitting bank to conduct the initial due diligence. In one particular case, a payment of K10 million by a Government Department to a company was cleared by BPNG and wired through to the company's account held at a commercial bank. Details held by the commercial bank reveal that the company was registered about less than two months before the payment was made and had only K60 in its bank account when the K10 million was remitted. It was a clear suspicious transaction but the red-flag system of the commercial bank was unable to detect it because the funds were wired directly by BPNG via the KATS.

The guidelines issued by FIU on 2nd June 2011 do demand the banks to receive supporting documents from the customer in order to satisfy themselves (banks) that the transaction is legitimate and originate from a legitimate source. Under the second phase of KATS, the cheque truncation would capture the image of the cheque and transmit electronically for clearing and settlement. Say for instance, if BPNG as a participant conducts the primary transaction, then the only image transmitted is the cheque. The ability of other banks to conduct further due diligence on the transaction would be limited to the cheque image only.

### Conclusions

BPNG as a banker and financial agent of the Government does conduct financial transactions on behalf of the Government hence is a cash dealer for all purposes under POCA. However, BPNG does not have an AML division and has not been filing STRs with the FIU. Suspicious payments were cleared by BPNG with less than sufficient due diligence. BPNG's action against money laundering is not commensurate to the risk thereof.

Whilst the need for the establishment of an AML division at BPNG still remains, the advent of the KAT system has opened the flood gates and immensely increased the risks of money laundering, posed not only to BPNG itself but to other commercial banks that use and benefit from the KATS. Although it is appreciated that the introduction of the KATS is beneficial for business expediency, equally important are the mechanisms to detect and combat money laundering using the same system which is absent at present.

### Recommendations (13)

a) BPNG should establish an AML division with adequate resources and trained personnel assigned to deal with money laundering issues and commence reporting suspicious transactions to the FIU.

b) Pursuant to section 34 of the National Payment System Act 2013, BPNG should work with FIU to review the KAT system to incorporate AML mechanisms immediately.

c) The Attorney General should write to Minister for Treasury and Minister for Police to advise them of these recommendations to be implemented by BPNG and FIU respectively.

## 12.4 PNG FIU's Ability to Combat Money Laundering

### Findings

Pursuant to the POCA, the FIU is the national center for the receipt and analysis of suspicious transaction (STR) reports filed by banks. The analysis function is limited notably because the FIU has not been afforded access to all relevant information. So far most of the FIU's requests for information from other agencies have been rarely complied with; there is no legal basis for these agencies to provide the requested information. Since it became operational in 2009, the FIU is yet to create a useful (although informal) network of contacts with other key authorities.

FIU's effectiveness in attending to STRs, analyse them and make further follow-up inquiries are seriously undermined by its own deficiencies which include lack of resources and skilled officers. In most cases, banks just conduct their due diligence on the available documents and submit the reports to the FIU after the transaction had been processed.

It is the responsibility of the PNG FIU to study the trend of money laundering behaviour of certain class of persons and issue appropriate guidelines under section 14 (c) of POCA to remedy the situation. The FIU did issue guidelines for due diligence in relation to government cheques and payments in June 2011. Those guidelines particularly addressed certain typologies of transactions such as infrastructure projects and compensation payments amongst others but do not address payments associated with court judgements and legal fees.

### Conclusions

There is an apparent disconnection of communication between the FIU, the banks (cash dealers) and the Government Departments to effectively detect fraudulent payments. With an effective communication network, fraudulent payments could be prevented once the cheques are deposited. A telephone call to a responsible authority verifying the payment can prevent a costly investigation. In a case of court judgement payment from Department of Finance, banks continued to call up signatories of cheques at Department of Finance instead of the Solicitor General's Office for verification purposes.

### Recommendations (14)

a) The Government should empower the FIU with necessary resources and skilled manpower to enable them to perform their mandated functions under the POCA.

b) FIU should establish a 'Primary Contact Point' in the relevant government departments and other organizations to ensure seamless flow of information on money laundering issues. The same contact points should be made available to the banks.

c) The Attorney General should write to Minister for Treasury and Minister for Police to advise them of these recommendations to be implemented by BPNG and FIU respectively.

## 13 Insulating Public Servants against Political Interference

### Findings

Political directives were issued for the settlement of court judgements and legal fees. Political directives were even issued to Department of Finance and Treasury to draw funds out of non-cash reserve trust accounts without the requisite warrant authority. Officials from Department of Finance and Treasury confirmed that they were acting on political directives. There may have been other verbal instructions apart from the written directives available to ITFS. A detailed analysis of the facts has convinced the investigation team that the great majority of the officers succumbed to political pressures. It was found that public servants who facilitate fraudulent payments know the right thing to do under the circumstances but could not objectively do so because of the political pressures exerted on them from the top.

### Conclusions

Public Servants must be sufficiently insulated from political pressures that are designed to assault the essential neutrality and objectivity of an ethical public service. In PNG, many public servants are vulnerable to political pressure and more often than not, succumb to such pressures for fear of reprisals. Those people who intend to defeat the systems and unjustly enrich themselves have used politicians as an effective point of influence for their unjust causes.

### Recommendation (15)

A review has to be undertaken to protect public servants from political pressures that are designed to unnecessarily and unlawfully interfere with the bureaucracy.

## 14 Dealing with Habitual Misconducting Public Servants

### Findings

There are certain public servants whose carriers in the public service had been fraught with controversy yet continue to remain in those offices. Some of them have facilitated the fraudulent payments the subject of many investigations. Some of these public servants are known for their inappropriate behaviour, however are allowed to remain in the public service to carry on and spread their corrupted behaviour with total impunity.

### Conclusions

In the final analysis, the proper functioning of the systems and processes must depend in large part on the character of the people who are custodians of those systems and processes. The people are as good as the systems and processes. The best assurance against misuse of the systems and process lies in the calibre of persons who are appointed to those positions with the judgement, courage and independence to resist improper pressure and importuning, whether from people higher up or their own networks.

### Recommendation (16)

The Government should review the current disciplinary measures and penalties with a view to banning habitual misconducting public servants from the public service. There should also be training and awareness programs held in respective government departments to instil discipline in the workforce.

Authorized for release by:

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