

ICCA Audit Summary*French***Executive Summary****Introduction**

This document is a summary of the findings of an audit conducted by the International Center for Corporate Accountability, Inc. (ICCA) with regard to the commitments made by Freeport and PTFI in the area surrounding its mining operations in Papua, Indonesia. The field audit was concluded at the mine site in Papua, Indonesia during the period of November 23 – December 1, 2004. The actual field was preceded by intensive preparatory work by ICCA lasting over six months.

Freeport-McMoRan Copper & Gold, Inc. (Freeport) operates one of the world's largest copper and gold mines in the province of Papua, Indonesia. The operating subsidiary is PT Freeport Indonesia (PTFI). The mine faces a number of unusual challenges. It operates at more than 12,000 ft. above sea level, where the rainfall is over 300 inches per year. The high mountainous region is inhabited by tribal people, who until around 100+ years ago, had lived in almost complete isolation without any meaningful contact with the modern world. The massive mining operations have had a substantial impact on their way of life.

The Papuan region has had a history of political unrest with local tribes seeking independence from Indonesia. This has led to strong presence by the Indonesian army and police at the mine site and the area surrounding it. One inevitable outcome of this state of events has been rising conflict between the Indonesian army and local police on the one hand and the Papuan people on the other hand. Given the mine's strategic location, and its importance to all parties, it is not surprising that PTFI has been accused of being entangled in these conflicts. This situation has resulted in accusations against the company by the local tribes, and also by international human rights groups, for cooperating with the Indonesian security forces and thereby becoming involved in human rights abuses. This was especially true in the period from 1994 through 1996.

Among other things, the company has been accused of discrimination against the Papuan people in job training and employment, disregard of Papuan people's traditional rights, and a neglect of the Papuan peoples' social and economic development. In response to these challenges and criticisms the management of FCX and PTFI undertook a number of initiatives to strengthen the company's relationships with the local communities through enhanced employment opportunities, social and economic development in the communities near PTFI's mining operations, and policies and programs to protect human rights in PTFI's operations area.

Scope of the Audit

This audit was conducted by ICCA at the behest of Freeport and PTFI, which guaranteed that ICCA's audit findings would not be modified by the company. At the same time, Freeport would have the right to include its responses, without editing by ICCA, in the final audit report. ICCA confirms that both these conditions have been met. ICCA also confirms that in conducting its audit, it received full support from the management at the mine site, in interviewing workers, providing access to documents, and logistical support in facilitating ICCA's conduct of the audit.

The scope of the audit included: protection of human rights, hiring and employment opportunities for the Papuan people, and social and economic development of the Papuan community. These provisions are described in detail in the company's Guiding Principles of Operations in Indonesia (GPOI – 1) and its Social, Employment and Human Rights Policy (SEHR).

Given the complexity and large size of the mining operations, Phase I of the audit was limited to the three core operating units of PTFI, i.e., surface mining, underground mining, and milling. Also included were critical administrative and support services units, and Security Department. A third element of the audit was the education-related activities of the Freeport Partnership Fund (LPMAK). Phase I audit covers approximately 9,350 people representing 65% of PTFI's total workforce including contractors and privatized companies. The technical details, policies and procedures covering the audit are presented in the full report.

The essential components of this field audit were:

- a) detailed confidential, one-on-one interviews with a randomly selected representative group of workers;
- b) examination of the company's relevant records and documents;
- c) interviews with management personnel;
- d) site visits to various community-related facilities; and,
- e) meetings with local area community leaders and businesses.

Phase II of the audit will cover the remaining business, administrative and support services units of PTFI as well as its contractors and privatized companies. The timing and other details of the Phase II audit would be determined at a later date once all formalities connected with the Phase I audit have been completed.

Organization of this Report

The audit is an evaluation of PTFI's compliance with its commitments made in the SEHR and supported by the GPOI-1. The audit begins, however, with a report on the occurrence of verifiable human rights violations in PTFI's operations area. In addition a report is being sent to the management of Freeport-McMoRan Copper & Gold and PTFI, which contains recommendations to PTFI about areas where PTFI is in compliance with its commitments, but where, in the judgment of the auditors, PTFI could do a better job in meeting its commitments. Further, the overall report is divided into an Executive Summary of the audit and its findings followed by the full report. For many readers, the Executive Summary will be sufficient to understand PTFI's commitments to its employees, the local community, stakeholders and shareholders. For others, the more detailed report will be useful to understand better the complexities of PTFI's operations and the success of its operations.

FREEMPORT AND PTFI COMMITMENTS IN SEHR AND GPOI-1

I. Promotion of Human Rights Policies and Prevention of Human Rights Abuses

One of the most important issues pertaining to the audit was the prevention of human rights abuses for which the company had been accused in the past, and protection and respect for human rights in all aspects of the company's operations. To address this issue in a comprehensive manner, Freeport and its Indonesian subsidiary, PTFI, undertook a number of initiatives:

In 1999, Freeport adopted a comprehensive Human Rights Policy, which was subsequently modified to become the "Social, Employment, and Human Rights Policy" (SEHR). It was adopted by the FCX Board of Directors and PTFI Board of Commissioners in December 2004. To support this corporate policy, Freeport and PTFI earlier created a code of conduct called "Guiding Principles for Indonesian Operations – People and the Community" (GPOI – 1) and made it public in April 2003." These documents obligated all PTFI managers and employees at the mining facility, including those of its contractors and privatized companies, to comply with these policies.

Audit Findings

ICCA confirms that all potential human rights violations have been reported to the appropriate authorities and dealt with in accordance with PTFI's human rights policy. None of the reported human rights violations involved activities of PTFI's Security personnel or by security personnel of the government of Indonesia in protection of PTFI's operations or property. The reported incidents fell within the realm of criminal acts and were dealt with accordingly.

For the record, it should be noted that ICCA did not investigate the ambush and shooting of members of the staff of the international school at Tembagapura since those shootings are being investigated by the U.S. Federal Bureau of Investigation and by the Government of Indonesia.

Required Corrective Action

None

II. Human Rights Training Program

In 2002, PTFI launched a human rights training program to make certain that PTFI personnel were sufficiently knowledgeable in human rights and human rights violations. This action was directed to ensure that all PTFI personnel would be able to avoid violating the rights of employees and members of the local community and would be able to accurately report on human rights violations if they saw them being committed. The annual training is required of all Security Department (SD) and Social and Local Development (SLD) personnel regardless of their rank, because their jobs require them to deal with issues concerning PTFI (including Papuan) employees and the external community. In addition, all senior supervisory personnel, and all Security and Community Development personnel are required annually to sign a Human Rights Assurance Letter indicating that they are familiar with PTFI's human rights policies and procedures, know how to handle complaints with regard to potential human rights violations and have not been part of nor know of any human rights violations. PTFI's expectation was that this program would become the lynchpin toward creating an improved understanding of human rights issues, better management of activities where human rights abuses were likely to occur, and effective implementation of policies and procedures to control and resolve issues that create the potential for human rights abuses.

Audit Findings

ICCA's assessment of the training program indicates that the program has been carefully articulated and well suited for PTFI's operating environment. The program emphasizes employees' awareness of six major provisions of the SEHR policy, i.e., (a) everyone should be treated fairly and equally; (b) there should be no discrimination based on race, sex, or ethnicity; (c) every individual, regardless of ethnicity, should be equally treated with respect; (d) everyone should have the right to join a group, or not join a group; (e) no one should be forced to work against his/her wishes; and (f) there should be no discrimination between Papuans and Non-Papuans in employment, promotion, and training programs.

PTFI's senior management is committed to the human rights portion of the SEHR and has provided resources for training for employees in human rights. In 2004, 5,400 employees (including contractors and privatized employees) attended this training. Among the employees interviewed by ICCA, over 78% had received human rights training. However, among those who had acknowledged to receiving this training, nearly 20% failed to answer any question correctly by responding "no answer" or don't know". Another 20% of the interviewed employees could answer only one or two questions correctly. A little over 40% could answer all questions correctly. The greatest awareness and learning from the training program appears to have occurred among the workers who were at the lowest level of employment hierarchy and temporary workers supplied by contractors. These workers also had the lowest level of education. Furthermore workers expressing greater concern with possible human rights abuses and discrimination were also the workers who demonstrated the best understanding of the human rights training program.

Two departments at PTFI have the greatest interaction with the local community: the SD and the SLD Department. Of the two, the Security department has the greater responsibility to protect human rights. Therefore, the SD has the greatest need to understand PTFI's human rights policy and program.

Although over 90% of SD personnel attended the human rights training, and the average length of the training period was approximately 12.0 hours compared to an average of 4.0 hrs. reported by the interviewed workers from the rest of the worker population, interviews indicated that 59% of SD personnel do not have a sufficient understanding of the Company's human rights policies and programs.

Required Corrective Action

PTFI must continue and enhance its training of all employees:

- (1) in the knowledge of PTFI's human rights policy;
- (2) in the specific human rights requirements as outlined in the Universal Declaration of Human Rights and the Voluntary Principles on Security and Human Rights; and,
- (3) the importance of reporting any potential human rights violations to management in accordance with PTFI's human rights policy.
- (4) it is especially important the PTFI's SD do a better job in these areas.
- (5) PTFI should provide a report to ICCA as to the changes it plans to make in its human rights training program in order to make it more effective together with a time-line for the implementation of the revised program. ICCA would like to receive this report no later than October 31, 2005.

III. Security Department Personnel Working with Indonesian Army Personnel

PTFI has made a public commitment to make transparent logistical and financial support to Indonesian security forces (police and army). The audit revealed that eight (8) PTFI SD personnel were assigned to government security forces to drive personnel from the lowlands to the highland. The use of PTFI vehicles by government security forces and the provision of PTFI personnel to provide transportation for the police and army was a major issue in 1994 and 1996 when there were human rights violations in the area around the mine and a major reason why the religious and human rights communities accused PTFI of being complicit with security forces in human rights violations.

Audit Findings

PTFI has worked to separate its equipment and personnel from that of the government. The use of PTFI drivers for government security forces blurs those distinctions for the local and international communities. ICCA considers this practice to be contrary to the spirit of the company's human rights policies.

Required Corrective Action

PTFI's SD should establish a policy of keeping PTFI SD personnel separated from operations of Indonesian government security forces. With PTFI's logistical support for Indonesian security forces now being transparent, so also should the activities of PTFI's SD personnel.

IV. Enhancement in Training and Employment of the Papuans at PTFI

Over the last 8+ years, the company has made certain specific commitments, and adopted general principles through various documents. These commitments have been collected in its Guiding Principles (GPOI-I) with a view to increase Papuan employment at the mine site, and also to improve their opportunities for future employment and promotion. In 1996, PTFI committed itself to double the employment of the Papuan people at the mine site by the year 2000, and double it again by the year 2006. The cumulative effect of these two initiatives would call 2,580 Papuan Non-Staff and 100 Papuan Staff in the workforce of PTFI by 2006.

In 2002, the company initiated a highly focused and technically oriented training program that would prepare people for jobs at the mine site. The program gives first preference to the Papuan candidates, especially those from the seven local tribes. PTFI also undertook to create a work environment, which would prevent discrimination against the Papuan people in all aspects of their employment at PTFI.

Audit Findings

The audit indicated that the company met its obligation of doubling the Papuan employment by 2001 and that it was on track for doubling this number again by 2006. Among the Staff, PTFI had already exceeded the target of 100 by 100% (200 Papuan Staff). ICCA's survey data, which is based on a statistically valid representation of PTFI's workforce, indicated that PTFI would indeed meet its target of doubling Papuan employment in 2006 among the business segments covered in Phase I audit. In one sense that could be seen as completing the audit process about employment. However, the issue about Papuan employment cannot end with reaching an employment goal alone; it must also deal with on-going issues of Papuan employee satisfaction, fair treatment for Papuans in the workforce and enhanced advancement opportunities in the future. ICCA's report to PTFI's management will address many of these issues, but two crucial issues must be raised in the audit itself.

After PTFI made its Papuan employment commitment in 1996, it refined its targets to give special preference to Papuans from the seven tribal groups that live closest to the mine. However, no numerical target for 7-sukus employment over employment of non-7-suku Papuans has been made. It should, however, be noted that of the Papuans in our interview sample only 15% of the total group indicated belonging to one of those selected tribal groups (7-sukus), although the employment data supplied by PTFI show that 43% of Papuan employees belong to one of these groups. The data also show that Papuan Non-Staff are being promoted at a rate equal to those of Non-Papuans, and that Papuans from the 7-sukus are being promoted among staff at a higher percentage than non-7-suku Papuans and Non-Papuans. The ability of PTFI to train and employ Papuans from the 7-sukus is crucial for both the Papuan community and PTFI. PTFI has developed a number of training programs specially oriented toward Papuans and focused on the people from the 7-sukus. It is important that these programs be supported and enhanced. PTFI also must continue to enhance the employment climate for Papuans.

The audit identified an issue with PTFI's use of contract labor suppliers. Indonesia, like many countries, permits employees working in certain jobs to be employed by contract labor providers. In Indonesia workers may be so employed for a period of up to three years. From the earliest days of the mine, laborers have tended to work through labor providers. During mine expansion in the early 1990s, many workers were employed on that basis. The audit found that there are currently approximately 1,500 workers who work under contract to labor providers, 16% of the PTFI workforce. 28% of these workers have been employed through this means for more than three years.

This is not *per se* a Papuan employment issue, since there is no significant difference in the percentage of Papuans and Non-Papuans who are employed through contract labor providers. The issue came to light when

workers reported that they either currently are or have been working for PTFI through contract labor providers for periods longer than is permitted under Indonesian labor law. Of the workers sampled, 20% reported having been employed by PTFI through contract labor providers for a period of four years or more. Only 9% of those who reported being employed for four years or more by contract labor providers were Papuans and 23% were Non-Papuans (although for those reporting that they were employed through contract labor providers for more than two years but less than four years, the opposite was true: Papuans made up 39% of that group and Non-Papuans made up 23% of the sample), so the issue is not one of discrimination. The issue is that some workers are being employed through contract labor providers for lengths of time beyond what is permitted by Indonesian labor law suppliers.

Workers employed through contract labor providers make less than permanent workers who do the same job while on the PTFI payroll. However, they do not cost PTFI less because of the payments the company makes to the contract labor providers. Workers who work for PTFI under agreements with the labor providers are supervised by PTFI perform the same work as direct PTFI employees, except with regard to salaries and benefits. PTFI's employment data show that all contract workers irrespective of their region of origin receive the same pay. There were complaints from Papuan workers about who was transferred from working for contract labor providers to the PTFI payroll, including accusations of nepotism, bribes, ethnicity and other subjective consideration affecting transfers. The data show that Papuan contractors are being transferred to the PTFI payroll at the same rate as Non-Papuans. However, the perception of workers about unequal treatment should be a concern to PTFI.

Required Corrective Action

It appears likely that PTFI will fulfill its commitments with regard to Papuan employment by 2006. Therefore, no corrective action is called for with regard to commitments made in SEHR or GPOI-1. However, there remain significant challenges for PTFI and the Papuan community with regard to training and employment. As the pool of educated people in the 7-sukus is depleted, effective remedial education and training becomes essential. PTFI has established a training institute, which shows promise of success. These efforts must be reinforced and intensified. In the long-run, the internal development of Papuan employees will become more important than the recruitment of new Papuan employees. Many Papuans entered the workforce lacking the required skills and thus are at the bottom of the employment ladder; they will stay there unless effective programs continue for their personal and professional development and additional incentives put in place for supervisors to enhance the development of Papuan employees. ICCA has provided recommendations to the management of PTFI on ways to further enhance the employment and advancement opportunities for Papuans.

An area that does require corrective action pertains to workers who remain with contract labor suppliers for extended periods of time while working under the management of PTFI and doing similar jobs as PTFI employees. ICCA has set out the following corrective actions for PTFI's management:

- a) Discontinue using contractor-supplied workers, except within the letter and spirit of Indonesian labor law. PTFI must also normalize wages between PTFI employees and those workers supplied by contract labor providers providing that skill levels are equal.
- b) Modify contracts with contract labor suppliers and other vendors so that contractor-supplied workers doing the same work as their PTFI counterparts and having the same skill levels receive the same pay and benefits.
- c) Create a set of guidelines clearly specifying the conditions under which contractor-supplied workers can be hired by PTFI. These guidelines must also define the conditions of "temporariness" that would apply to contractor-supplied workers. They must also meet the relevant provision of the Indonesian labor laws and PTFI's code of conduct. All contractor-supplied workers hired under the new guidelines must be paid wages and benefits equal to those paid to their counterparts on the PTFI payroll. The revised guidelines must also create an objective and transparent set of rules in case of transfers from contractor to the PTFI payroll. Where contract labor suppliers are used by PTFI as a place for training workers and as a probationary period, the need for such training and the extent of the probationary period must be clearly defined and justified. They must also be in compliance with the Indonesian labor laws.
- d) Finally, given the importance of this issue in terms of fairness and equity, and also for the negative perception it creates among the Papuan workers, ICCA would recommend that:
 - i. PTFI prepare a detailed plan of corrective action, including a timetable for its completion.
 - ii. This plan should be submitted to ICCA and agreed by PTFI and ICCA.
 - iii. ICCA would undertake a follow-up audit within 6-9 months of this plan's initiation, to ensure that it has been fully implemented.

V. Social Development of the Papuan People

In late 1960s, Papuan communities in South-Eastern Indonesia were primarily characterized as traditional economic systems with dominant hunting and gathering and agricultural lifestyles. Freeport's mining development brought along social and economic challenges and opportunities to the local tribal

communities. To gain communities' support and prevent violence and social unrest and to help enhance the opportunities available to the local communities, Freeport, in the early stage of its Indonesian operations, applied a strategy of infrastructure development and direct monetary subsidies to the communities.

More recently, this approach has been modified through a long-term social and business development plan to enhance relationships between PTFI and local communities. One area of importance to the well-being of the Papuan community was the need for developing a more diversified base of economic activity. Freeport and PTFI recognized this challenge and its efforts have taken two forms.

1. The company created a department of Social and Local Development (SLD), which is entirely funded and supervised by PTFI. SLD's mandate is to implement programs to which PTFI has made public commitments.
2. Freeport and PTFI also created the Freeport Partnership Fund for Community Development with a commitment to allocate annually 1% of PTFI's gross operating revenues to the Fund. Estimated at between US \$18-20 million per year, the contribution is to continue until the year 2006, and after that Freeport plans to continue the program for another five years.

By any measure, this is a substantial amount of money both in absolute and relative terms. These contributions are a direct, voluntary commitment on the part of PTFI. Another important feature of the fund is that it is entirely managed by the Papuan community through its organizational entity, Lembaga Pengembangan Masyarakat Amungme dan Kamoro (LPMAM), subject to Freeport-established Donor Guidelines to ensure financial integrity and performance accountability.

ICCA's Audit Findings

I. Social and Local Development Department (SLD)

SLD is an integral part of PTFI and reflects corporate priorities in its goal development and program priorities. However, it works closely with LPMAM in implementing community development programs focused on education, health and local business development. SLD's primary focus is on three groups of activities.

1. Community Business Development (CBD) is the largest group, responsible for about 45% of SLD's operations. It focuses on specific projects aimed at facilitating entrepreneurship among local communities, agricultural development, farms and fishing. One of its major activities is to provide consultation and training to the local communities in the areas of social and business development.

From ICCA's perspective, SLD is a remarkable success story. First, it is the notion of finding entrepreneurs and risk takers among a people where competition new to the culture and where business activity is not a customary means of acquiring status and power in the tribal community. Second, the area suffers from poor opportunities of economic growth. Apart from the mine and mine-related enterprises, the local economy does offers few other sources of producing goods and services that are large enough to create a more diversified base for enhanced economic activity.

2. CBD's Business Incubator Program aims to take people who are inclined to start new business and help them with a basic understanding of business start-up process, financial plans, and elementary aspects of sales, purchasing, customer service, inventory management, bookkeeping, etc. If we consider success as a proportion of incubator program start-ups which become self-sustaining profitable enterprises, despite their small size, than we can say that this program is successful. Between 2002 and 2004, 40 small and medium business enterprises were supported or assisted by CBD, and of these, 77% are generating positive cash flow. Also, PTFI assisted business have provided work opportunities for over 1,200 local people.
3. Information Support and Liaison Office (ISLO). The primary role of this organization is to serve as liaison with the local communities. ICCA's investigations indicated that CLO was providing a needed service to the community. CLO officers are well respected in the community, and especially in the far flung villages, where their liaison activities and support services among the villages are particularly helpful.

A review of CLO's modus operandi would suggest that CLO could be made even more effective and productive by shifting its program focus from activities performed to results achieved. For example, if future performance focused on eradicating a specific problem.

Required Corrective Action

PTFI has clearly fulfilled its commitments to the local community through the programs that it has developed for and with the local community. ICCA recognizes the many challenges that all parties face in creating effective models for development. However, ICCA believes that PTFI can further refine its models with regard to community development.

In this context, ICCA has made a number of recommendations with the goal of achieving long term operating efficiencies and also orienting SLD toward "deliverables achieved" rather than activities performed. These

recommendations, when fully implemented should make a demonstrable difference in the positive impact that SLD can make in the economic and social life of the Papuan community

II. Freeport Partnership Fund and LPMMAK

The Lembaga Pengembangan Masyarakat Amungme dan Kamoro (LPMMAK) was established in 2002 to manage the Freeport Partnership Fund. The Fund and its predecessor organization were established in the early part of 1996 and has received US \$132 million over the 9-year period. PTFI funds the Freeport Partnership Fund with one-percent of the gross revenue from its Indonesian operations. When the program began in 1996, Freeport decided that Fund would be managed by the local community. However, the local community lacked the experience to manage such large sums of money effectively. A number of management structures were tried from 1998 through 2002, and while each was an improvement over what had gone before, it was clear that further changes were necessary. Between 2002 and 2003 a new structure evolved, which has generally served the local community well.

As presently constituted, LPMMAK has a dual governance structure. The management of LPMMAK comprises of a Board of Commissioners (Badan Musyawarah or BM), consisting of representatives from the local government, Papuan regional leaders, leaders from the Amungme and Kamoro, and representatives from PTFI. The Board of Commissioners establishes annual budgets for three main development areas: Education, Health, and Village Development. The second board is the Board of Directors (Badan Pengurus or BP) and is responsible for approving overall budgets for various programs, oversight of plan implementation, and managing external financial audits. The responsibility for daily operations and program management lies with the Executive Secretary.

To support the LPMMAK PTFI established Community Management Services (CMS), which provides technical and professional advisory services to LPMMAK in planning, managing, and monitoring social programs sponsored by the 1% fund. CMS personnel are employed by PTFI, but work directly with the Executive Secretary of LPMMAK and the various bureaus set up by LPMMAK to administer the Freeport Partnership Fund. CMS also acts as the implementers of PTFI's Donor Guidance.

ICCA's Observations and Audit Findings

The audit has found that PTFI has made the required payments to the Freeport Partnership Fund and the Fund has made available those monies to the LPMMAK as stipulated in the Donor Guidance. LPMMAK's programs cover a wide-variety of activities ranging from health education, public health and malaria

control, community development, infrastructure development to education and training. By mutual agreement between ICCA and PTFI, Phase-I of this audit was limited to the activities of LPMAC's Education Bureau. Other activities of LPMAC will be covered in Phase-II of the audit.

Education Bureau

The Education Bureau oversees planning and implementation of six major programs. These are: Scholarship Programs; Dormitories; Out of School and Adult Education/Skills Training; Cooperation with the Government; Infrastructure; and Cooperation with Third Parties: Bank, Foundation, and Church. Two of the six programs, i.e., educational assistance/scholarships and dormitories have accounted for 96% of LPMAC's spending on educational programs. Therefore, these programs were subjected to careful analysis by ICCA during this audit.

Educational Assistance/Scholarships. This program has suffered from the growing pains of a new organization with insufficient management experience, inadequate financial controls, reporting, and accountability systems. In 1996, the program began giving educational aid to more than 5,000 students per year at an annual cost which ranged between \$3.0 and \$5.9 million. The educational aid ranged from small amounts for school uniforms and school supplies for elementary students to full scholarships for university students. The data show that approximately 80% of those receiving educational subsidies were pre-school through high school students and 20% were attending universities.

Exact expenditures for the program are not available for the period of 1996-2000. The program spending between 2001 and 2004 was approximately US \$11.9 million. Data are not available as to how many persons were granted scholarships. There was also no system in place to monitor the progress of scholarship recipients. For the period 1996-2001, no information is available on the success or the failure of the program in terms of students who completed their educational programs. LPMAC also does not have any information as to the status of their current employment.

Two things about the academic scholarship program are worth noting. One, the scholarship program has consumed almost 50% of the Bureau's budget since its inception. Two, this situation has not materially changed even after prodigious efforts by the current management of the Education Bureau. The Bureau states that the scholarship program, in the condition it was inherited, suffered from problems of weak infrastructural support, weak logistics and absence of policies and procedures. LPMAC did not have any other option but to continue support to 4,000 students who were receiving educational assistance.

While ICCA understands the emerging management of the Education Bureau as it seeks to improve the management of the education function of LPMAC and understanding of the cultural sensitivities with which the Education

Bureau must deal, it finds that the Education Bureau's inability to manage the program effectively are symptomatic of management which does not have the capacity to administer such a program.

Dormitories. There is a paucity of high schools in many parts of the area served by LPMMAK and the Freeport Partnership Fund, young people often live in dormitories while pursuing education away from their homes. The Education Bureau of LPMMAK has built, maintained, and operates a number of dormitories, not only in the Timika area (mostly for high school students), but also in other parts of Papua (for high school and college students) and in areas within Indonesia where Papuan students, especially those from the 7-sukus area, are attending a university. In terms of spending, dormitories are the second major project of the Education Bureau after the scholarship program. From 2001 through June 2004, almost US \$2.5 million had been spent on the dormitories.

The Education Bureau of LPMMAK has a variety of models for how it supports dormitories. In some cases LPMMAK directly contracts the management staff for dormitories and the dormitory section head monitors the day-to-day operations. In other cases, LPMMAK is responsible for the construction of individual dormitories, and once completed, it turns them over either to a church or a foundation for management. For the dorms managed by the church and foundations, LPMMAK's support consists of providing funds for operational costs such as food, bedding, and utilities; school uniforms; routine maintenance; and renovations needed to keep these dorms up to standard.

The Education Bureau indicated that many dormitories suffer from poor maintenance and insufficient supervision. ICCA visited a girls' dormitory located in the Timika area, within 30-minutes driving distance from the Education Bureau's offices. The condition of the dormitory and the conditions in which the girls lived were unacceptable with regard to safety, hygiene, and conditions that would be conducive to effective learning. Given below is a brief summary of the findings of the ICCA team:

- a. At the time of the ICCA audit visit, the dorm had been without electricity for several months. There were no working lights or fans for the students living in the dormitory.
- b. The restrooms in the dormitory have no doors. Also, there are insufficient restrooms when compared with the number of occupants in the facility.
- c. The bedrooms are small and have poor ventilation. On average six people share a room of approximately 150 square feet.
- d. The kitchen has poor ventilation and no running water.
- e. There is no transportation available to the school. Girls have to walk long distances along heavy trafficked roads to their schools.

- f. The dormitory has no security and there were reported incidents when young men from a boys' dormitory tried to break into the girls' dormitory.

Out-of-School and Adult Education Programs

Approximately 1% of the total funds of LPMAC are devoted to out-of-school and adult education programs. These fall under two categories: remedial education and adult education. Remedial education programs are intended for young adults who are currently enrolled in school. This program also gets support from the local government.

The Education Bureau could not adequately explain its involvement in remedial education programs other than indicating that public schools are failing in their responsibility of educating the youth. Adult education programs are aimed at young adults in order to make them more employable. These programs do not guarantee jobs to participants. Instead, they aim to enhance skill sets and help students with basic knowledge, which makes them better qualified to seek jobs. LPMAC has recently agreed to fund 10 students in the PTFI Apprenticeship program.

Partnership with the Government and Management of Infrastructure Projects

ICCA was unable to evaluate these two programs due to time constraints during its on-site audit visit in November 2004. We expect to undertake this evaluation during Phase II of the audit.

Audit Findings

ICCA's overall finding with regard to LPMAC's management of educational program is unsatisfactory. It is distressing to note that the top leadership of LPMAC has allowed this situation to deteriorate to an unacceptable level given the importance of this program to the Papuan community, and the fact that it has consumed a large part of LPMAC's annual funding. The program must be considered as unequivocal failure both from operational and fiscal management perspective.

LPMAC as the local community's administration of the Freeport Partnership Fund is the right way forward for all parties. The local community's ability to set goals and develop their own programs not only allows the local community to make certain programs fit local priorities, but it also allows the community to gain experience in self-governance and independence. However, giving so much control to a local community that is not yet experienced in management has inherent challenges. One must ask what responsibility PTFI,

as the sole donor to the local community, has when a program administered by others proves unsuccessful.

Equally, this situation causes consternation for ICCA as an auditor. ICCA's advisors are aware of cultural sensitivities and what the local community sees as outsiders "holding on to the tail" and being critical of them and their efforts. Therefore, it is tempting to gloss-over the failures of the local community in administering programs. It is also a temptation for PTFI to say that it has little or no responsibility for poorly run programs in the local community because it has given the funding that was promised and the programs are administered by the local community. However, in an area of such importance as education, no glossing-over is acceptable.

Required Corrective Action

The entire relationship between PTFI, the Freeport Partnership Fund, and the LPMAC must continue to be rethought and redeveloped. Even though cursory inspection of other programs administered by LPMAC leads ICCA to believe that the Education Bureau is the weakest part of the LPMAC programs, it is clear that there are financial and human resources that could be more effectively used by the community.

As part of the rethinking and redeveloping of PTFI's relationship with LPMAC, PTFI must take responsibility for getting the Education Bureau to do what needs to be done to establish an educational program for the area surrounding PTFI's mining operations. There is a special and immediate need for PTFI through LPMAC to take action to correct the situation at the dormitories. Although some might argue that the conditions in the dormitory are not that different from the conditions found in the villages from which the students come, the dormitories must be maintained to the standard at which they were intended.