

AUDIT FINDINGS ON THE FUND FOR THE
NATIONAL FOREST RESOURCE PROTECTION
PROJECT

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The National Audit Office of the People's Republic of China
(CNAO)

Audit Findings on the Fund for the Natural Forest Resource Protection Project

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In compliance with the *Audit Law of the People's Republic of China*, in the latter half of 2006 the National Audit Office of China (CNAO) conducted an audit on the fund for the Natural Forest Resource Protection Project (referred to hereafter as the NFRP Project), covering national and local input between 2004 and June 2006 in eight provinces (and autonomous regions) including Yunnan, Sichuan, Gansu, Shanxi, Henan, Inner Mongolia, Jilin and Heilongjiang (Greater Hinggan Mountain Forestry Group Co. included) and their 33 affiliated counties, forestry operation bureaus, forestry bureaus (referred to hereafter as “counties and bureaus”). The CNAO made a study on the performance while implementing some part of projects.

1. Basic Situation and Overall Assessment

The Implementation Program of the NFRP Project (referred to hereafter as the Implementation Plan) in the key forested areas on the upper reaches of the Yangtze River, upper and middle reaches of the Yellow River, in the Northeast and Inner Mongolia, approved by the State

Council in 2000, decided that from 2000 to 2010, the NFRP Project would be implemented in 17 provinces (and autonomous regions, municipalities) with the planned investment of 96.2 billion yuan. In the 8 provinces (autonomous region) under audit this time, the planned investment for the NFRP Project was 15.97 billion yuan between 2004 and 2006, among which, 14.34 billion yuan had actually been appropriated by June 2006, accounting for 89.8% of the planned total. Of the paid sum, the fund from the central government was appropriated in full amount and 42.7% of the counterpart fund from the localities was in place. The total audited fund this time stood at 4.93 billion yuan, representing 34.4% of the appropriated fund in the 8 provinces (and autonomous regions).

The audit findings indicated that the State Forestry Administration (SFA) played a role of organization, coordination, direction and supervision in the implementation of the NFRP Project in accordance with the Implementation Plan. And the governments of eight provinces (and autonomous regions) made their efforts in enhancing project fund management, speeding up the construction of ecological and public beneficial forests, clarifying responsibilities for forest resource management and preservation and promoting relocation and resettlement of surplus staff in forestry enterprises. The progress of the NFRP Project proceeded smoothly as a whole.

(1) Identify responsibilities, strengthen management and gradually standardize the use of fund. The SFA faithfully carried out the requirement of “notifying goals, tasks, fund and responsibilities of the project to the provinces” put forward in the Implementation Program and clarified that the provincial governments bore the full responsibility for the implementation of the project. Following this requirement, the people’s governments of eight provinces (and autonomous regions) divided up the goals and tasks to different levels and gradually set up an internal control regime of fund management and a responsibility mechanism for fund security. Accounting centers were set up in most key state-owned forested areas to review and consolidate the accounts of NFRP Project fund. Every year the SFA carried out review over fund management and project implementation of the NFRP Project. The eight provinces (and autonomous region) conducted self-checking as well. As a result, the fund appropriation, management and utilization in the NFRP Project were standardized step by step.

(2) The construction tasks of public beneficial forests were basically implemented and the responsibilities for forestry resource management and preservation generally fulfilled. First, the construction task of public beneficial forests was carried out as scheduled. From 2000 to 2006, in the 6 provinces (and autonomous region) including Yunnan, Sichuan, Gansu, Shanxi, Henan and Inner Mongolia on the upper reaches of the Yangtze River and the upper and middle reaches of the Yellow River, 69.97

million mu (1 mu equals 1/6 acre) of public beneficial forests were planted, representing 101% of the planned target. The quality of afforestation basically met the state standards of acceptance. Second, the responsibilities for forest management and preservation were fulfilled in accordance with the Implementation Plan. The 33 counties and bureaus under audit and study all took the measures to introduce the family contract system of management and preservation in the near mountainous areas and to close hillsides to facilitate afforestation in the remote mountainous areas. By the end of 2005, the contracts signed for forests management and preservation totaled 143 million mu of forests, representing 105% of planned tasks of the Implementation Plan.

(3) The lop quotas were under effective control and the target of the NFRP Project to reduce timber production was basically met. In the Tenth Five Year Plan period, the SFA strictly followed the annual lop quotas approved by the State Council to assign planned lumbering quotas to the localities (accounting for 75.8% of the lop quotas). In accordance with the targets set in the Implementation Plan, since 2000, five provinces (and autonomous region) on the upper reaches of the Yangtze River and upper and middle reaches of the Yellow River ceased commercialized lopping of natural forests in an all-around manner. The state forested areas in the Northeast and Inner Mongolia cut down timber production step by step. In 2003, the plan of timber production reduction was strictly put into place. The timber production in 2005 was 39.5% less than that in 1999,

basically meeting the target of 40% reduction.

(4) The resettlement of the surplus staff in forestry enterprises was fulfilled on a whole. As required by the Implementation Plan, a total of 612,000 surplus staff in forestry enterprises was covered by the relocation and resettlement plan in eight provinces (and autonomous regions). By the end of June 2006, 695,000 people had been relocated and resettled, representing 113% of the planned target. Among them, 303,000 people were permanently resettled, representing 106% of the plan. 392,000 people were transferred to other sections of forestry resource management and preservation, afforestation and other areas, representing 120% of the plan.

The audit findings disclosed that due to time pressure in drafting the Implementation Plan, the long duration of project implementation and other reasons, there are some problems to be corrected and improved in using project fund, facilitating the development of forestry enterprises, raising income of the staff and ensuring the security of the forestry resources.

2. Main Audit Findings and Audit Recommendations

(1) Irregularities and Low Performance in the Use of NFRP Project Fund

First, 130 million yuan of NFRP Project fund was used in violation of the regulations, accounting for 2.7% of 4.93 billion yuan, the total sum of the audited fund. To be specific, there were 80.07 million yuan misappropriated, 22.49 million yuan fraudulently claimed through false documents, 29.78 million yuan retained without appropriation and 2.8 million yuan used beyond construction standard. For instance, Diebu Forestry Bureau of Gansu Province fraudulently claimed 21.284 million yuan of subsidy in the name of permanent resettlement for surplus staff of forestry enterprises, instead, they lent the fund to subsidiary companies and forest farms to invest in real estate or meet operation expenditure. Shangri-La County (one of the State's key poverty-relief counties) of Yunnan Province scheduled to erect 49 bulletin boards for the NFRP Project with a planned investment of 2,700 yuan each or 123,000 yuan in total. However, in real practice waste and extravagance led to the expenditure of 1.066 million yuan in total and 118,400 yuan each .

Second, there was a big surplus in the subsidy fund from the central government for basic old-age insurance of forestry enterprises. Since launching the NFRP Project, the central government allocated the subsidy to cover basic old-age insurance of forestry enterprises every year. The subsidy was appropriated all along “without change”, following the number of staff and standard of 1997 as identified in the Implementation Plan. After the relocation and resettlement of surplus staff in forestry enterprises, however, the actual number of staff drastically reduced,

resulting in a big surplus of the central government's subsidy for forestry enterprises. Through sample test, it was found that the surplus amount of the departments and units concerned in five provinces of Yunnan, Sichuan, Gansu, Shanxi and Heilongjiang hit 240 million yuan, representing 33.4% of the total central government old-age insurance subsidies appropriated in the same period of time.

(2) Heavy Burden on Forestry Enterprises

One, since launching the NFRP Project, the administrative fees and profit submitted by the major state forestry enterprises to their superior administrative departments in the Northeast and Inner Mongolia kept increasing on yearly base. This practice was not against the rules, but the burden of these enterprises got heavier year by year, offsetting somewhat welfare of the subsidy fund given by the state in the NFRP Project. From 2000 to 2005, 5 forestry enterprises including Greater Hinggan Mountain Forestry Group Co. received from the central government 21.38 billion yuan of financial subsidies as the expenditure for forest management and preservation and basic pension of their affiliated enterprises. At the same time, however, the 5 forestry enterprises required their affiliated enterprises to submit administrative fees and profit increased year on year. The submitted sum in 2005 was 1.5 times that in 2000, with the total sum in these 6 years reaching 2.69 billion yuan.

Two, the state policy of debt forgiveness to the forestry enterprises in the NFRP Project was not implemented in an all-round way. In June 2005, the state notified that it would waive 7.85 billion of debt owed by the first batch of financial institutions of forestry enterprises (including banks and financial assets management companies) in 8 provinces (autonomous region). Until November 2006, 4.91 billion yuan of debt was not yet forgiven. Of the sum, 3.49 billion yuan of debt (71%) should have been waived by financial assets management companies concerned. As there is no clear policy provision on how to compensate the loss of the financial management companies in handling the debt , this part of debt was not waived.

(3) There Exist Problems Affecting Security of Forestry Resources in the NFRP Project Areas

One is indiscriminate and illegal felling. According to the data provided by 28 counties and bureaus, in 2004, 1,882 cubic meters of timber was felled indiscriminately and illegally. In 2005 the amount went up to 4,146 cubic meters, an increase of 120.2%. From 2003 to 2004, the Municipal Highway Administrative Bureau of Luoyang in Henan Province built a highway on 71 mu of land in the NFRP Project area and arbitrarily cut 281 cubic meters of timber without permission. In 2005, Xing'an Mining Co. Ltd. in Huma County, Heilongjiang Province, before obtaining mining rights, mined iron ore in the NFRP Project area, unlawfully

occupied 89 mu of wooded land and destroyed 35 cubic meters of timber.

Two is the threat to forestry resources reserve. For example, in 2005, 70% of the felled timber cut by Longjiang Forestry Group within the production quota of the NFRP Project, came from nearly mature and middle-aged forests which are used as reserve forestry resources. The main reason is that the growing stock of mature and over-mature forests, the main source for lumbering industry (not including that of the felling-forbidden areas), account only 4.3% of its total forest reserves. For another example, in 2005 in the forest reserves of the Greater Hinggan Forestry Area of Heilongjiang, the reserves of mature and over-mature forests decreased by 41% compared to that in 1997, a time before the implementation of the NFRP Project. This shows that the main resources suitable for lumbering were on constant decrease.

In view of the problems discovered in the audit, the CNAO has issued audit report and audit decisions in accordance with the law and at the same time made the following recommendations:

First, adjust the relevant content of the Implementation Program. In the past more than 6 years since launching the NFRP Project, great changes took place concerning the numbers of the staff of forestry enterprises, the standard for pension contributions, consumer prices and forestry resources compared to that of early implementation stage of the NFRP

Project. The policies set by the Implementation Program either did not conform, or not entirely, to the actual situation. The relevant state agencies should, proceeding from the actual situation, adjust the content of the Implementation Program. One is to dynamically allocate financial subsidies for basic old insurance and others in line with the changed numbers of the staff of the forestry enterprises, wages and commodities pricing levels so as to improve the performance fund usage. Two is to further cut down timber production of the state forested areas in the Northeast and Inner Mongolia to a rational level to facilitate the rehabilitation and growth of reserve forestry resources. Three is to highly value and study the possible resolution to non-appropriation of the counterpart fund from the localities so as to better ensure the funding needs for implementing NFRP Project.

Second, ease the burden of the forestry enterprises. Currently, the burdens of the forestry enterprises come not only the debt burden left over by history, but also the burden brought about by mixed function of government and enterprise and management system of social undertakings operated by enterprises. To release the heavy burden of the forestry enterprises, the state and departments concerned should coordinate and waive their debts in an early manner. Then, the forestry competent authorities, other departments concerned and the governments at various levels of the NFRP Project should accelerate the reform of state-owned forestry enterprises and further improve their corporate

governance in compliance with the requirement of the *Decisions of the Central Committee of the Communist Party of China and the State Council on Accelerating the Development of the Forestry Industry*,.

Third, boost supervision and management. The forestry competent authorities, other relevant departments as well as the governments at various levels in the NFRP Project areas should earnestly correct or urge the correction of the problems of retaining, misappropriating and using illegally NFRP Project fund which were found in the audit, examination and self-examination, continually improve the fund supervision and management system of NFRP Project and step up cracking down on indiscriminate and unlawful felling of forestry resources.

3. Implementation of Audit Recommendations

The State Forestry Administration and the people's governments of 8 provinces (autonomous region) took the audit findings seriously. The SFA said that the efforts should be made in the following seven key areas: One, convene a teleconference on rectification work on the problems found in the audit, require the localities to formulate and carry out specific rectifying measures and launch an overall examination on the NFRP Project implementation. Two, further perfect the rules and regulations on project construction. It was mainly to set up a relevant system and supervisory and restraining mechanism for the key or weak links during

project implementation. Three, urge more vigorously for rectification in various localities. The supervisory groups will be sent to examine the provinces and autonomous regions with key problems and urge them for prompt action. Measures will be taken to publicly criticize those provinces and autonomous regions with bad performance in rectification and suspend the appropriation of their project fund if necessary. Four, in the first half of this year, there will be an internal audit on some NFRP Project fund which was not covered by the audit in 2006. Five, cooperate with the National Development and Reform Commission and the Ministry of Finance to adjust the Implementation Program of the NFRP Project. Six, strengthen training of management staff and engineering personnel at various levels to raise their policy awareness and improve professional capabilities. Seven, enhance the research on and guidance to the reform of forestry enterprises, coordinate and bring the related policies into full play, and ease the burden of the forestry enterprises in a practical manner so as to create favorable conditions for NFRP Project progress and the reform of the forestry enterprises. By the end of January 2007, the rectification in various localities produced initial results and the problem of 50.93 million yuan of fund involved in the irregularities was solved, accounting for 37.7% of the total. Rectification was completed in Yunnan, Heilongjiang, Shanxi provinces and the Inner Mongolia Autonomous Region.

Appendix: List of the 8 Provinces (Autonomous Region) under the Audit

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1. Yunnan Province (upper reaches of the Yangtze River)
2. Sichuan Province (upper reaches of the Yangtze River)
3. Gansu Province (upper reaches of the Yellow River)
4. Shanxi Province (middle reaches of the Yellow River)
5. Henan Province (middle reaches for the Yellow River)
6. Inner Mongolia Autonomous Region (middle reaches of the Yellow River and a key state forested area in Inner Mongolia)
7. Jilin Province (a key forested area in the Northeast)
8. Heilongjiang Province (including Greater Hinggan Forestry Group Co., a key state forested area in the Northeast)