

ASIAN DEVELOPMENT BANK



**PROJECT PROCUREMENT- RELATED AUDIT REPORT
Loan 1997-AFG
EMERGENCY INFRASTRUCTURE REHABILITATION AND
RECONSTRUCTION PROJECT**

This report has been abbreviated in accordance with the Asian Development Bank's Public Communications Policy (PCP). In particular, it excludes confidential and other information in accordance with paragraph 126 of the PCP, items 9, 11, 12, 14 & 15.

**Office of the Auditor General
Integrity Division**

13 February 2009

ABBREVIATIONS

ADB	-	Asian Development Bank
AFRM	-	Afghanistan Resident Mission
EA	-	Executing Agency
EIRRP	-	Emergency Infrastructure Rehabilitation and Reconstruction Project
GoA		Government of Afghanistan
JFPR	-	Japan Fund for Poverty Reduction, funded by the Government of Japan
ICB	-	International Competitive Bidding
LCB	-	Local Competitive Bidding
MIWRE	-	Ministry of Water Resources, Irrigation and Environment
MoF	-	Ministry of Finance
MPW	-	Ministry of Public Works
MWP	-	Ministry of Water and Power
OAGI	-	Office of the Auditor General, Integrity Division
PCU	-	Project Coordination Unit
PIU	-	Project Implementation Unit
PPRA	-	Project Procurement Related Audit
SDR	-	Special Drawing Rights
SOE	-	Statement of Expenditures

NOTE

In this report, \$ refers to US dollars.

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EXECUTIVE SUMMARY

1. This report documents findings and makes recommendations as a result of the project procurement-related audit (PPRA) on Asian Development Bank (ADB) Loan No. 1997-AFG (SF) Emergency Infrastructure Rehabilitation & Reconstruction Project (EIRRP or the Project) carried out in Afghanistan.
2. The EIRRP aims to assist the Islamic Transitional State of Afghanistan in the rehabilitation and reconstruction of key infrastructure. Most of the infrastructure in Afghanistan was destroyed or damaged due to two decades of war between 1979 and 2001. The EIRRP aims to rehabilitate and reconstruct
 - the primary national road network in the north of the country (\$81 million),
 - power transmission lines in the northern provinces and the distribution system in Kabul (\$46 million),
 - damaged gas production, transmission and distribution facilities (\$23 million), and
 - irrigation infrastructure and implementation capacity thereof (\$17 million).¹
3. The loan from ADB of SDR² 110 million – equivalent to \$150 million at the time - was signed on 1 August 2003 and became active soon after, during the transitional administration of the Afghan Transition Administration (ATA), led by President Karzai. As per ADB records as of 31 December 2007, 24 contracts had been awarded under the Project, representing a total amount of \$107 million (67% of the loan principal), with \$98 million (65%) already disbursed by ADB.
4. Co-financing of a further \$20 million was subsequently added to EIRRP funds, provided through the Japan Fund for Poverty Reduction funded by the Government of Japan (JFPR), administered by ADB. At the Government of Afghanistan's (GoA) request, \$20 million of ADB's loan - previously allocated to the roads component of the project - was transferred to the gas and irrigation components of the project in June 2004, maintaining ADB's commitment at SDR 110 million.
5. These were understandably very challenging times for the country, made even more difficult by volatile logistical and security situation. The enormous task of rebuilding Afghanistan required strong support from the international community, and ADB was part of the effort then, and continues to support ongoing development efforts.³
6. The EIRRP is also a complex project, in that it involves four separate sectors and multiple project locations over a wide area. Multiple-sector projects are inherently more problematic to manage than single sector ones.
7. This report is written with those difficult circumstances in mind, and is cognizant that the audit findings may well have been different in a less volatile climate.

¹ Source: ADB Batch report for Loan 1997-AFG(SF) as at 31 December 2007.

² SDR = Special Drawing Rights, defined as a basket of currencies, consisting of the Euro, Japanese yen, pound sterling, and U.S. dollar. At the time, it was equivalent to \$150 million.

³ Approval of two ADB-financed multi tranche finance facilities was announced on 28 November 2008, to further improve the energy sector (\$570 million) and support road net work development (\$400 million) in Afghanistan.

8. The *Afghanistan National Development Strategy for 1387-1391 (2008-2013) (ANDS)* was recently issued during 2008. This significant document acknowledges that the GoA will not be able to achieve the ambitious goals set out in it without significant improvements in the effectiveness of aid.⁴ The GoA's aid effectiveness strategy is based on principles outlined in the 2005 *Paris Declaration for Aid Effectiveness*, including the principles and priorities of Afghan ownership, alignment of international assistance with the ANDS, harmonization, managing for development results and mutual accountability and partnership with international development aid partners such as ADB.

9. It is sincerely hoped that this report will help enhance aid effectiveness in the remaining life of the EIRRP, and future ADB-financed development efforts in Afghanistan. It is worthy to note that CWRD has agreed to the audit recommendations and shall reflect lessons learnt in the EIRRP's Completion Report and apply them, as appropriate in ongoing and future AFG projects.

Major Findings & Recommendations

10. The major findings and recommendations which arose from the conduct of this PPRA are described below.

Management Structure

11. It was noted that while the four components of the Project (road, power, gas and irrigation) was managed through *Project Implementation Units* (PIUs) from different ministries, no central *Project Coordination Unit* (PCU) was evident. The requirement for a PCU is outlined in the Loan Agreement.⁵

12. An internal ADB report in 2004 indicated that staff for such a unit had been appointed; however the Audit Team were unable to identify the staff of such a PCU. Whether such a unit once functionally existed but is now absent, is unclear.

13. This non-compliance with the Loan Agreement may well have resulted in a lack of intentional and central monitoring of over most of the EIRRP implementation to date.⁶ This in turn may have contributed to other audit findings which indicate significant non-compliance with ADB's requirements and weak project management controls.

14. CWRD must carry out regular and active monitoring to ensure the loan covenants required for future ADB-funded projects in Afghanistan are well considered in terms of practicality and anticipated benefits to the project, and ensure regular and active monitoring of compliance with such covenants throughout the life of the project.

Procurement – Audit Scope Limitation

15. The Audit Team encountered limitations during the audit that restricted its ability to conclude on aspects of the EIRRP's procurement processes.

⁴ ANDS, Section VIII, page 20.

⁵ Schedule 6.

⁶ As of the date of this report, the EIRRP is almost at the end of its active life.

Non availability of Bidding Documents

16. The Audit Team reviewed 100% of all contracts⁷ awarded as at 31 December 2007 with a cumulative value of \$107.8 million. This includes 24 separately listed contracts, all of which were reviewed by the Audit Team.

17. For 15 of the 24 contracts reviewed, EIRRP compliance with requirements under ADB's *Procurement Guidelines* could not be ascertained, due to documentary evidence of such compliance not being available. The total contract value for the 15 contracts is \$65.3 million.

18. 11 contracts *additional* to the 24 reviewed, valued at \$1.3 million and identified as procured through local competitive bids, were not separately listed⁸ in ADB records, which implies that ADB was only informed of the contracts being awarded at the time of replenishment, rather than promptly after contract awarding. Bidding documentation for these were reviewed by the Audit Team. We therefore cannot conclude if competitive bidding really took place for these contracts at the time of procurement.

Contract Variation – Audit Scope Limitation

19. According to PIU records, one major contract for road construction works under Part A of the EIRRP – awarded to a company hereafter referred to as Firm X – varied \$28 million *more* (as at October 2008) when compared to the original contract value of \$28.707 million (as at 11 April 2004)⁹ – i.e. the contract value was effectively *doubled*. Of the \$28 million difference, \$24 million was apparently the result of one \$24 million “contract variation” approved in July 2008.

20. It was determined that the \$24 million “contract valuation” was actually an addition to the value of the contract to be funded by ADB (previously to be funded by the GoA). The actual contract variation with Firm X should be for an additional \$28 million. Nonetheless, the Audit Team was not able to sight documentation or obtain clarification that allowed a conclusion to be made as to whether the \$28 million contract variation with Firm X was executed according to ADB guidelines.

21. This is a significant deviation that requires urgent attention. It must be established that the contract variation was properly executed, in line with previously approved change in scope and actual work done on site, appropriately approved by ADB, and that there is nothing improper in the manner in which the contract variation was effected. This matter will be investigated further under ADB's Integrity Principles & Guidelines.

Financial Management

Differences between financial records of the MoF, PIU and ADB

22. The Audit Team noted numerous and significant value differences between MoF, PIU and ADB records in relation to the list of contracts awarded, contract values and amounts disbursed. The Audit Team is of the opinion that one contributing factor is that ADB-financed

⁷ Per ADB records.

⁸ ADB normally assigns contracts awarded with PCSS (procurement contract summary sheet) numbers once informed of contract awarding.

⁹ Of the original contract value of \$28.707 million, \$20 million was co-financed by the JFPR (see paragraph 4), while ADB financed the remaining \$8.707 million.

portion of EIRRP funds is not separately accounted from the \$20 million co-financed by the JFPR in PIU records. In addition, it is unclear if the conversion rates and accounting adopted for the SDR equivalent of the loan is aligned with that used by ADB.

23. Reconciliation of financial records between the EIRRP and ADB *must* be performed to account for these differences.¹⁰ The sooner this is addressed, the better are the chances of identifying the reasons for these differences and taking appropriate action. Regular reconciliations are part of sound accounting practices expected under the Loan Agreement.

Asset Verification

24. From the audit team's inspection of project assets and works in 13 locations, it appeared that the EIRRP generally utilized loan proceeds for its intended purposes. Assets were in the appropriate locations and used for the purposes as intended by the Loan Agreement.

25. However, the Audit Team noted instances of sub-standard material being used and sub-standard work, indicating inadequate project supervision and a deviation from specifications agreed upon. While cognizant of the difficult security situation in the area, it is strongly recommended that the relevant project implementation units in charge actively monitor contracts in progress in order to ensure materials and work are at agreed standards, and hold the contractor and/or consultant accountable to meet agreed specifications and other contractual requirements.

Fraud & Corruption Indicators

26. There were indications that fraudulent and corrupt activity may have taken place. There may have been a significant conflict of interest in the awarding process of a consultancy contract in that a key official in the consultancy firm may be related to government officials involved in the awarding of the contract. In addition, there were irregularities in bid meeting attendance registers, which may indicate that these were fabricated. ADB will conduct further investigation of these in accordance with its *Integrity Principles and Guidelines*, and will seek the cooperation of the executing agency and Project staff at all levels in this effort.

27. Strong project management and internal controls serve to prevent and detect fraudulent and corrupt activity. As the EIRRP suffered from weak project management, it was not possible to identify clearly identify indicators of other fraudulent and corrupt activity. It is crucial that ADB requirements are complied with, as this will go a long way towards improving financial and operational management of the EIRRP.

Final Comments

28. It does appear that ADB itself did not monitor the progress of the project consistently or effectively. Complicating factors are the transfer of the Afghanistan portfolio between different regional and operational departments within ADB, and the high turnover of staff responsible. The pressure on international donors and partners to release urgently required funds to Afghanistan is also very likely a contributing factor.

29. Clear, intentional loan and project monitoring by ADB has to be in place right from the beginning of future ADB-funded projects in Afghanistan and maintained throughout the project,

¹⁰ The loan agreement and repayment schedule is denoted in SDR, while EIRRP records are in USD.

given its particular set of circumstances, so that all decisions are appropriately considered, authorized and documented. This would have provided much needed accountability in what was – and remains – a very urgent and necessary project implemented in difficult conditions.

30. Central West Asia Department (CWRD) may wish to address the absence of a central Project Coordination Unit as it remains a continuing breach of the requirement in the loan agreement that one be established.

31. The Audit Team would like to thank EIRRP staff for their cooperation and responsiveness to audit requirements. It also appreciates the particular support provided by ADB's Afghanistan Resident Mission in the conduct of this PPRA. ADB values the courtesies and support extended to the Audit Team.

I. PROJECT BACKGROUND

1. Asian Development Bank (ADB) Loan No. 1997-AFG(SF): Emergency Infrastructure Rehabilitation and Reconstruction Project (EIRRP or the Project) was designed to rehabilitate and reconstruct key infrastructure in Afghanistan, destroyed or damaged due to two decades of war. Lack of resources and capacity prevented maintenance, which led to major deterioration and loss of infrastructure.¹¹

2. The EIRRP comprises the following 4 components:

- **Part A: Road Infrastructure Rehabilitation and Reconstruction** –rehabilitation and reconstruction of the primary national road in the north, and the provision of consulting services for design review, supervision of civil works, and enhancement of operation and maintenance capacity of Ministry of Public Works (MPW).
- **Part B: Electric Power Infrastructure Rehabilitation and Reconstruction** - rehabilitation and reconstruction of transmission lines, improvement of physical and management aspects of power distribution in Kabul.
- **Part C: Gas Infrastructure Rehabilitation and Reconstruction** – provision and repair of equipment and structures, and institutional strengthening and training of Ministry of Mines and Industries (MMI) and Afghan Gas.
- **Part D: Irrigation Infrastructure Rehabilitation and Reconstruction** – implementation support for irrigation infrastructure, improving the infrastructure implementation capacity of the (then) Ministry of Water, Resources & Energy (MIWRE),¹² and rehabilitation of irrigation-related civil works.

3. ADB approved the project loan of SDR110 million on 3 June 2003, and the loan became effective on 1 August 2003.^{13 & 14} As at the date of this report, some \$138 million (80% of loan amount) has been awarded. Repayments on the loan are scheduled to begin in 2013.

4. Through supporting rehabilitation and reconstruction in the transport, power, gas and irrigation sectors, the EIRRP aims to

- contribute in reviving the economic activities across the country, thereby creating employment opportunities and reducing poverty,
- maximize utilization of local labor and provide equal employment opportunities to women,
- facilitate income generation at household levels, rehabilitation of displaced populations and ex-combatants, improvement of peace, security, and stability, inter-ethnic reconciliation, political unification of the country, regional cooperation and integration, natural resource development and conservation, and private sector development.

¹¹ Page I, *Report & Recommendation of the President (RRP:AFG36673)*, May 2003

¹² The MIWRE has since been absorbed into the Ministry of Energy and Water (MEW).

¹³ The Loan Agreement signed on 1 August 2003 for One Hundred and Ten Million and Eighteen Thousand Special Drawing Rights (SDR), which is a basket of currencies – Euro, Japanese Yen, British Pound and United States dollar – equivalent to \$150 million at the time.

¹⁴ In August 2003, JFPR co-financed an additional \$20 million to the EIRRP.

5. The Government of Afghanistan's (GoA) Ministry of Finance (MoF) was appointed executing agency for the EIRRP. The MoF was required to form Project Implementation Units (PIUs) responsible for each separate component of the EIRRP within 3 months of the loan becoming effective. In addition, the MoF was required to establish a Project Coordination Unit (PCU) within 6 months of the loan becoming effective, to coordinate with each PIU responsible for separate components of the EIRRP.

II. AUDIT OBJECTIVES, METHODOLOGY & SCOPE LIMITATION

6. The overall PPRA objective is to help prevent and detect fraud and corruption as defined under ADB's Anticorruption Policy.¹⁵ This policy, along with ADB's *Procurement Guidelines* and *Guidelines on the Use of Consultants* requires borrowers, bidders, suppliers, and contractors to maintain the highest ethical standards for ADB-financed activities.¹⁶ To ensure such ethical standards, ADB's Anticorruption Policy prohibits fraudulent and corrupt practices in ADB-financed operations and defines

- a *fraudulent* practice as any action, including misrepresentation, to obtain a financial or other benefit or avoid an obligation by deception,
- a *corrupt* practice as the offering, giving, receiving, soliciting, directly or indirectly anything of value to improperly influence the actions of another party,
- a *collusive* practice as an arrangement between two or more entities without the knowledge, but designed to improperly influence the actions, of another party, and
- a *coercive* practice as impairing or harming, or threatening to impair or harm, directly or indirectly, any party or the property of the party to influence improperly the actions of a party.¹⁷

7. In addition,

- a *conflict of interest* is defined as a situation in which a party has interests that could improperly influence that party's performance of official duties of responsibilities, contractual obligations, or compliance with applicable laws and regulations, and that such conflict of interest may contribute to or constitute a prohibited practice under the anticorruption policy.¹⁸

8. The PPRA is intended to;

- identify whether EIRRP procurement of goods, works and services complied with ADB's *Procurement Guidelines*, *Guidelines on the Use of Consultants* and the Loan Agreement¹⁹,
- determine whether EIRRP contracts were implemented according to agreed terms,

¹⁵ Paragraph 67, *ADB's Anticorruption Policy (2 July 1998)*

¹⁶ Paragraph 14(iii), *ADB's Anticorruption Policy (2 July 1998)*; Paragraph 1.06 *Guidelines for Procurement under Asian Development Bank Loans (November 2004)*; Paragraph 1.14, *Procurement Guidelines (February 2007)*; Paragraph 1.23, *Guidelines on the Use of Consultants (February 2007)*

¹⁷ Paragraph 2, *Integrity Principles and Guidelines (November 2006)*

¹⁸ Paragraph 50, *Integrity Principles and Guidelines (November 2006)*

¹⁹ The Project's Loan Agreement between the Transitional Islamic State of Afghanistan and the ADB was dated 1 August 2003, subsequently amended 29 June 2004.

- ensure ADB's funds were used for their intended purposes, and
- recommend improvements to internal controls that mitigate opportunities for fraud, corruption or abuse in the EIRRP and in future ADB-financed projects.

9. PPRA's are conducted in line with ADB's efforts to manage for development results. One intended outcome of a PPRA is to identify internal controls that should be in place or strengthened to mitigate or eliminate instances of fraud and corruption, or abuse of resources. Effectively applied internal controls give assurance that project funds are directed towards intended uses for intended beneficiaries. PPRA's thus contribute to ensuring ADB-financed projects are managed to produce intended development results.

10. To achieve the audit objectives, the Audit Team:

- a. Evaluated the Project's procurement processes for all 24 discrete procurement contracts awarded (totaling \$106.7 million, or 98% of loan committed) under the EIRRP as of 31 December 2007;
- b. Reviewed disbursement and financial management procedures on the above procurement contracts and 9 SOE-related contracts (1.2 million) covering 70% of the Project's disbursements as of 31 December 2007;
- c. Sought confirmation from third party vendors on contract and disbursement amounts, and conducted an analysis of potential conflicts of interest, for 23 selected contracts; and
- d. Inspected the Project's goods procured and works completed at 13 project sites in relation to 12 selected contracts.

11. An inherent limitation to the audit scope is the logistical and security concerns that existed during the progress of the audit. The original intention of the PPRA was also to assess the reasonableness and competitiveness of contract prices. However, this was difficult to establish given the difficult market conditions prevalent in Afghanistan – especially during the early years of EIRRP – and time and security risk considerations during the progress of the audit.

12. As of 31 December 2007, ADB's records²⁰ indicated that the EIRRP had the following profile:

²⁰ Source: Batch Report for Loan 1997-AFG (SF) as at 31 December 2007. Note that loan committed here is \$167 million, a combination of SDR withdrawn calculated at prevailing rates at the time of withdrawals, plus SDR remaining available at prevailing rate for at the time of reporting.

Description	Part – A	#	Part – B	#	Part - C	#	Part - D	#	Total
Loan committed ²¹	81,011,480		45,690,192		23,532,109		16,894,208		167,127,989
%	48.5		27.3		14.1		10.1		100
Disbursement									
Direct payment	51,242,145	4	37,157,088	4	337,977	4	7,661,340	12	96,398,550
SOE (Imprest)	309,442		-		91,068		-		400,510
Interest	1,157,774		-		-		-		1,157,774
Un – allocated	47,590		50,000		52,350		568,928		718,868
Total	52,756,951		37,207,088		481,395		8,230,268		98,675,702
%	53.5		37.7		0.4		8.4		100
Unutilized	28,254,529		8,483,104		23,050,714		8,663,940		68,452,287
Contracts awarded	54,924,309		40,607,466		814,000		11,100,750		107,446,525
	# = Number of contracts awarded.								

III. AUDIT FINDINGS

13. The PPRA findings are summarized into the following sections: (i) Project Management (ii) Procurement & Consultancy Services; (ii) Financial Management; (iii) Third Party Confirmations & Conflict of Interest; (iv) Asset Inspection.

A. Project Management

Project Coordination Unit

14. Schedule 6 of the Loan Agreement stipulates that the MoF as the executing agency was to have set up a Project Coordinating Unit (PCU) within the MoF to monitor project implementation and coordinate with the PIUs²². The presence of such a PCU – or project officials that were part of such a PCU - was not evident during the Audit Team’s visit to the MoF and PIUs.

15. Although there was a central disbursement control function performed by the Special Disbursement Unit within the Budget Department and Treasury Division of the MoF, the Audit Team could find no evidence of a PCU that performed the following duties as required in the Loan Agreement:

- Monitor project implementation,²³
- Coordinate with the PIUs,²⁴
- Oversee EIRRP activities and milestones,²⁵

²¹ The difference in the total loan funds of \$170 million as previously explained, and the \$167 million is as yet un-reconciled, but is probably due to the original loan principal being denoted as SDR 110 million, equivalent *at the time* to \$150 million, but loan *committed* is calculated at SDR rates at time of withdrawal.

²² Section 6, Schedule 6, Loan Agreement

²³ Section 6, Schedule 6. Loan Agreement

²⁴ Section 6, Schedule 6. Loan Agreement

²⁵ Section 6, Schedule 6. Loan Agreement

- Establish a Project Steering Committee (consisting of ministers of the PIUs) to provide overall oversight and guidance required for smooth and timely implementation of the Project,²⁶
- Establish a system for preparing quarterly reports for performance monitoring, issues resolution, and periodic action plans,²⁷
- Undertake qualitative and quantitative project performance monitoring for each component,²⁸ and
- develop a comprehensive project performance monitoring system.²⁹

16. Enquiries at ADB Headquarters indicated that, as far as they were aware, a PCU had been established within 3 months of loan effectiveness. Corroboration of this is provided in an internal document produced in 2004 that logs the progress of the EIRRP.³⁰ According to CWRD, their point of contact has always been the MoF, and that their impression was that MoF personnel were the effective PCU for the project. Whether such a unit once functionally existed but is now absent, is unclear.

17. This significant non-compliance with the Loan Agreement may well have resulted in a lack of intentional and central monitoring of over most of the EIRRP implementation to date. The benefits outlined above have been lost to the project. A functioning and effective PCU would have considerably enhanced aid effectiveness of the EIRRP. The lack of a functioning PCU may well have contributed to adverse audit findings that follow, resulting in weak internal controls and a heightened risk of incidence of fraud and corruption.

Recommendation

18. If the project management structure stipulated in the Loan Agreement are found to be impractical or unnecessary once a project commences – as have might been the case here with the PCU - CWRD must provide justification for the changed structure, and initiate the necessary modifications to loan covenants. This clarifies covenants that ADB expect the project and country to comply with, and mirrors actual practice.

19. Having determined the loan covenants that are to be complied with, CWRD should then make certain that compliance with such covenants is maintained throughout the life of the project.

Project Implementation Units

20. In contrast, PIUs for the EIRRP were set up as required by the Loan Agreement, headed by appropriately experienced project directors. It also appears that reasonable accounting processes are in place with financial disbursements tracked, EIRRP accounts prepared and audited, and progress reports regularly prepared. However, reconciliation of accounts with both MoF and ADB is unsatisfactory.

²⁶ Section 6, Schedule 6. Loan Agreement

²⁷ Section 18, Schedule 6. Loan Agreement,

²⁸ Section 21, Schedule 6. Loan Agreement

²⁹ Section 22, Schedule 6. Loan Agreement

³⁰ Project Performance Report dated 29 February 2004, 'Other Covenants' section 3. The entry indicates that recruitment of staff for PCU in MOF, and PIUS in MPW, MMI and MWP was "complete."

Recommendations

21. Areas for improvement are identified as follows:

- Utilize recognized accounting software to maintain EIRRP financial records instead of the spreadsheets currently used, and
- Ensure project staff responsibilities are properly delineated.

22. These will enhance financial monitoring of EIRRP implementation, improve internal controls (including appropriate segregation of duties) and supervision, and enhance the integrity of - and provide transparency in - the accounting function.

B. Procurement & Consultancy Services

23. Schedule 4 of the Loan Agreement outlines ADB requirements in relation to procurement of goods and services, while Schedule 5 outlines requirements in relation to consulting services. These schedules refer to ADB's *Procurement Guidelines* and *Guidelines on the Use of Consultants* respectively.

Contract Variation – Audit Scope Limitation

24. According to PIU records, one major contract for road construction works under Part A of the EIRRP - awarded to a company referred to as Firm X in this document – varied \$28 million *more* (as of October 2008) when compared to the original contract value of \$28.707 million (as of April 2004).³¹ The contract value was effectively *doubled* according to PIU records. Of the \$28 million difference, \$24 million was the result of one “contract variation” approved in July 2008. Neither the contractor nor consultant at the project site,³² or the relevant PIU, when questioned in October 2008, was able to provide the Audit Team with satisfactory answers as to why the “variation” was required.

25. Further investigation at ADB revealed that the “variation” actually represented the increase in ADB *funding* of that contract. The actual variation to Firm X's contract was an additional \$28 million. The following paragraphs provide a short synopsis of the events leading to this.

26. A major change to the original scope of Firm X's contract specifications - estimated at an additional \$31 million – was proposed in October 2006 by the MoF. This change of scope was approved by ADB.³³ ADB was to co-finance \$5 million of the variation from a reallocation of loan funds - also duly approved by ADB³⁴ - while the GoA was to finance the remaining \$26 million.

27. There was however no indication that ADB had *approved the \$28 million contract variation* between the MPW and Firm X. This is a separate approval process, and is mandatory

³¹ Of the original contract value of \$28.707 million, \$20 million was co-financed by the JFPR (see paragraph 4), while ADB financed the remaining \$8.707 million.

³² Queries were made of project engineers on site during asset verification field visits in October 2008.

³³ Approval of the change in project scope and reallocation of loan funds is contained in a CWRD internal memorandum dated 31 October 2006.

³⁴ See footnote 5.

for such a major contract variation.³⁵ The EA may have considered approval of the change in scope and related cost estimates as sufficient approval to proceed.³⁶ There is no indication that ADB sought to review and approve the actual contract variation agreement itself,

28. In 2007, the GoA advised ADB that it was unable to finance their portion of the variation. The outcome of discussions resulted in ADB approving a *reallocation* of funds (within the loan) to finance the remaining shortfall of \$24 million relating to the Firm X contract. *This* is the \$24 million “contract variation” previously referred to.

29. While the Audit Team is satisfied the change of scope and reallocation of loan funds has been appropriately justified and approved, it remains unable to conclude if the actual contract variation itself was prepared and executed in accordance with ADB guidelines. This is a significant deviation from ADB’s Procurement Guidelines and requires urgent attention. It must be established that the contract variation was properly executed, in line with previously approved change in scope and actual work done on site, appropriately approved by ADB, and that there is nothing improper in the manner in which the contract variation was effected. This matter will be investigated further under ADB’s Integrity Principles & Guidelines.

Recommendation

30. It is strongly recommended that
- The PIU involved – MPW – provide ADB with a copy of its contract variation agreement with Firm X. In the absence of a contract variation, ADB should consider appropriate remedial action.
 - The EA and PIUs be informed that ADB approval of contract variations is a separate procedure to that of ADB approval of a change in scope, cost estimates and funding.
 - CWRD steps up its due diligence and project monitoring mechanisms, especially with variations of this significance. The potential for fraud and corruption to infiltrate the procurement process is very real and can be significantly mitigated through strong project monitoring by ADB.

Non Availability of Bid Documentation

31. The Audit Team was unable to assess if the EIRRP properly complied with ADB’s *Procurement Guidelines* and *Guidelines on the Use of Consultants*, and the Loan Agreement. This was primarily due to key bidding documents not made available to the Audit Team – a severe restriction in audit scope. Documents were disorganized and kept in disparate locations. Many documents requested remained unavailable despite persistent efforts and enquiry by the Audit Team.

32. Table 1 is a high level summary of required bid documents that were not available – either missing or not in existence. These cover all the 24 procurement contracts documented in ADB’s records that had been awarded by EIRRP up to 31 December 2007, plus an additional 11 discrete contracts identified during the audit. The profile below clearly indicates the limitation faced by the Audit Team in assessing the propriety of the bid evaluation process.

³⁵ Paragraph 3, Appendix 1, *Procurement Guidelines*

³⁶ Memos exchanged between MoF, DEF Corporation and Firm X between February and May 2007.

Table 1: Summary of Bid Documentation either Missing or Not in Existence

Bid Documentation	Implication (resulting in a less than competitive and transparent bid process)	No. of Contracts affected out of the 24 reviewed
Evidence of the Pre-qualification invitation / advertisement or special/general notice not available (required for ICB and LCB procurement modes)	May not have taken place, or may not have taken place with sufficient time allowed for preparation and submission of bids.	6
Expression of interest and prequalification documents from bidders	May not have taken place to identify all potential qualified and interested parties	3
Standard Bidding document not available	May not have been prepared for use of all interested bidders	7
Technical & Price proposal not available ³⁷	Unclear if these were received and/or properly evaluated	8
Bid evaluation report not available	Unclear if these were done, or done properly by authorized persons	1
Bid performance security either not available or available but expired	Leaves EIRRP vulnerable in situations of non-performance	4
Log register, attendance record and other supporting documents not available	Required bid meetings (such as bid opening) may not have taken place	3
Minutes of pre-bid and tender opening committee meetings either not approved or not available	Meetings may not have taken place and/or may not be a true and fair account of events.	1
'No Objection' certification from ADB was not available for contract variations	Non-compliance with Procurement Guidelines	2³⁸
Evidence of the publication of the award of the contracts not available	May not have taken place	9

33. The Audit Team formally requested the assistance of the MoF and PIUs in locating documentation during meetings in Kabul on August 18 and 19, 2008, subsequently followed up by written communications. In particular, some bid documents were identified as being located at the project office in Mazar-e-Sharif located in northern Afghanistan. However, the Audit Team could not locate these documents when they visited the area in October 2008.

34. The Audit Team had great difficulty locating bidding documentation for three contracts targeted for international competitive bidding. For these contracts, the PIU indicated that ADB had awarded requisite 'no objection letters', but did not provide further information about the location of bidding documents. However, subsequent enquiries at ADB Headquarters revealed that the bidding process was conducted by ADB.

³⁷ The number here indicates proposals that were not available for *winning* bidders only.

³⁸ In addition, 2 other contract variations without required 'no objection' certificate was noted. These were in relation to the 11 contracts identified in paragraphs 30-33.

35. For 15 of the 24 contracts reviewed, EIRRP compliance with requirements under ADB's *Procurement Guidelines* could not be ascertained, due to documentary evidence of such compliance not being available. The total contract value for the 15 contracts is \$65.3 million.

36. Contracts were varied by more than 15% of the original agreed value, which require a 'no objection' certificate to be issued by ADB. Four contracts had contract variations of more than 15% of the original contract value, but were not accompanied by any clearance from ADB.³⁹

37. The Audit Team acknowledges that the turnover of responsible staff at the executing agency, PIUs and ADB has resulted in confusion as to project procurement practices at the time. The Audit Team pursued its attempts to locate and sight its requested bid documentation until October 2008 on the field, then until January 2009 at ADB Headquarters.⁴⁰

38. This is unfortunately an additional restriction to the scope of the audit. For the contracts affected, the Audit Team was unable to evaluate if the procurement process encouraged competitive bidding and was otherwise conducted in line with ADB's *Procurement Guidelines* and *Guidelines on the Use of Consultants*, and without violation of ADB's Anticorruption Policy.

Contracts in addition to the 24 reviewed above

39. As per the Loan Agreement, each civil works contract estimating more than USD 1 million, and each supply contract for equipment or materials, estimating more than USD 500,000⁴¹ shall be awarded on the basis of International Competitive Bidding (ICB). Civil works contracts amounting to \$1.0 million or less, and contracts for supply of equipment and materials valued at \$500,000 or less (except for minor items) shall be procured through International Shopping. Contracts awarded under the irrigation component (Part D), valued at \$20,000 or less may be procured through direct selection to allow for community participation.⁴²

40. From the above provisions, it is apparent that all contracts except small-value civil works under Part D should be competitively bid. During the Audit Team's review of the PIU's imprest account for Part D, it was discovered that 11 contracts with values ranging from \$26,000 to \$442,000 were awarded, and these were reportedly procured through Local Competitive Bidding (LCB).

41. While the circumstances may have allowed for LCB, there is no evidence of ADB's approval or post-review of subject contracts. ADB *Procurement Guidelines* requires that contracts should be subject to pre-review (where ADB approval is required to award the contract) or post-review (where ADB needs to be informed, but contract may be awarded without such approval).^{43 & 44}

42. Further, these contracts were not assigned separate procurement contract numbers by ADB, while payments were all drawn from the imprest account. This indicates that ADB was not

³⁹ This is required by ADB's *Procurement Guidelines*, Appendix 1, Paragraph 3.

⁴⁰ This included attempts to locate documentation at ADB headquarters in Manila.

⁴¹ Schedule 4, paragraph 5

⁴² Schedule 3, paragraphs 1 & 4 of the Loan Agreement Amendment

⁴³ The Loan Agreement does not specifically address requirements in relation to LCBs.

⁴⁴ Appendix 1 of the *Procurement Guidelines* addresses ADB review of procurement decisions.

made immediately aware of the contract award until the replenishment of the amounts disbursed from the imprest account.⁴⁵

Fraud & Corruption Indicators

43. One of the interviews resulted in the allegation that there was a significant conflict of interest affecting the procurement process of one of the consulting contracts. One of the key officers of the consulting firm was said to be related to, or otherwise have close relationships with, government officials and related ministers that were involved in the awarding of the contract.

44. Comparison of attendance registers of bid meetings held also indicate that:

- Signatures and handwriting are different for the attendees with the same name,
- Presence of consultants were indicated in bid interviews, but their names were not logged, and
- Meeting attendance sheet for one contract relates to a different contract.

It is possible that registers are not a true representation of the event, that attendees misrepresented their name and position, and/or the registers were fabricated, all of which are potential violations of ADB's *Anticorruption Policy*.

45. OAGI will further investigate these matters in accordance with ADB's *Integrity Principles and Guidelines*, to establish whether or not ADB's Anticorruption Policy was violated.

Recommendations

46. For the remaining life of the EIRRP, and future development projects in the pipeline for Afghanistan involving the same ministries, it is strongly recommended that:

- Each PIU set up a central storage for all documentation related to contracts under their responsibility,
- Proper bid procedures as required by ADB be properly initiated and managed by the executing agency, to ensure as competitive a process as possible to maximize the effective use of project funds,
- Bid documentation as indicated in Table 1, along with other necessary documentation, be properly effected and maintained.

C. Financial Management

47. The Loan Agreement specifies the terms and conditions applicable in relation to loan-related financial transactions. The Loan Agreement also outlines particular covenants that require the funds be used for intended purposes and intended beneficiaries, as well as the expectation that funds will be accounted for in line with sound accounting principles.⁴⁶

⁴⁵ PIU response to queries indicated that these contracts were paid through the imprest account to facilitate payment while the Special Disbursements Unit within the Ministry of Finance was undergoing reform.

⁴⁶ Article IV, Sections 4.01-4.10.

Significant differences in Financial Records of MoF, PIU and ADB

48. It was found that there were significant differences between MoF, PIU and ADB records, and while we understand work is ongoing, financial records of MoF and PIUs have not been satisfactorily reconciled with those at ADB. Table 2 provides a high level summary of findings. These cover the 24 contracts previously mentioned, as well as additional 11 contracts subsequently discovered as paid through the imprest account.

Table 2: Summary of Audit Findings in relation to Financial Management

Financial Management & Disbursement Review	Implication	No. of Contracts
Disbursements from Imprest account exceeding the prescribed ceiling	Contravention of Loan Agreement conditions, large disbursements not monitored	3
Certain contracts appearing in ADB's record but not appearing in PIU's record	Contract deliverables cannot be verified by the PPRA	2
4 Invoices were paid to one contractor through direct payment without interim payment certificates	Payments made without proper certification as to the quality and progress of civil works.	2
Difference in the disbursed amounts (\$20 million overall)	Unclear what the true financial picture of the EIRRP is without full reconciliation of PIU records with ADB records.	19
Difference in the contracted amounts (\$44 million overall)		24
Withdrawal applications (totaling \$0.7 million) appearing in ADB's records but not appearing in PIU's record		9
Exchange rates of SDR against USD were applied correctly to calculate the equivalent amount of loan in USD	MoF may not be correctly calculating its debt to ADB	5
Progress reports not available	Monitoring of EIRRP financial progress not possible for these periods.	3

49. All of the 4 payments without interim payment certificates were made to one same contractor. The EIRRP may have been financially vulnerable should there be/have been non-compliance with the terms and conditions of the contracts involved.

50. Amounts disbursed in ADB's records differ from PIU records in 19 instances, the overall net difference totaling approximately \$20 million. Amounts contracted per ADB's records differ

from PIU records in 22 instances, the net value being approximately \$44 million. The Audit Team is of the opinion that one contributing factor is that the ADB-financed portion of EIRRP funds is not separately accounted from other co-financed portions of EIRRP funds in PIU records.⁴⁷

51. Table 2 also indicates instances where the MoF have used SDR/\$ conversion rates different to those used by ADB when recording \$ equivalent amounts in accounting for the loan. It is unclear if the basis of accounting adopted by MoF for the loan is the same as that used by ADB. MoF cannot therefore be sure what amount it owes to ADB.

Recommendations

52. The existence of contract payments made inappropriately through the imprest account, financial records not reconciled, along with the difficulty in obtaining bid documentation for audit review previously discussed, does not provide reassurance to the Audit Team that the EIRRP has not been the target of fraudulent and corrupt activity.

53. Reconciliations are vital to ensure that EIRRP funds have not been misappropriated and/or otherwise lost, to ensure use of EIRRP funds have been properly accounted for, and to enable the GoA to determine the level of loan drawdown.

54. For the GoA - through its ministries - to assure donors of transparency and good intent in relation to its development activity, we strongly recommend that internal control systems and procedures are set up so as to provide such reassurance. Specifically:

- The MoF should coordinate centrally, reconciliations between its records, PIU records and ADB records for contracts awarded, contract values, amounts disbursed, and the amount owed to ADB for Loan 1997-AFG(SF).
- The MoF and PIUs should separately account for the ADB-financed portion of EIRRP funds.
- MoF should confer with ADB to align its basis for loan accounting, and at periodic intervals thereafter agree on the amount of loan utilized both in SDR and \$.
- No further payments should be made through the imprest account contrary to conditions contained in firstly, the Loan Agreement and secondly, ADB's *Loan Disbursement Handbook*.
- Payments should only be made with appropriate certification where required.
- Other applicable guidelines in the Loan Agreement and the Loan Disbursement Handbook should be complied with.

D. Third Party Confirmation & Conflict of Interest

55. The Audit Team requested confirmations from contractors in relation to delivery of goods and services, and payments made to them. This included a conflict-of-interest review, prepared based on ADB's *Guidelines on the Use of Consultants*.

⁴⁷ Significant differences were identified in relation to the contract awarded to Firm X (\$19.9 million for amounts disbursed, and \$42.9 million for amounts contracted)

56. From 23 confirmation requests sent, 11 responses were received. Three of the 11 responses provided payment figures that did not reconcile with EIRRP records. At the date of this report, these amounts remain un-reconciled.

Fraud & Corruption Indicator

57. The same 11 responded with the conflict of interest checklist, which were followed up by the Audit Team with interviews with selected contractors and consultants. While the results of these were not conclusive, the following are worth noting:

- Contractors appeared unaware of ADB's stand on conflict of interest, and
- There were allegations of conflict of interest in relation to the awarding of a contract for consultancy services.

58. OAGI will further investigate these matters in accordance with ADB's *Integrity Principles and Guidelines*, to establish whether or not ADB's Anticorruption Policy was violated.

Recommendation

59. Ministry officials of the GoA are encouraged to be clear about its obligations in relation to ADB's *Anticorruption Policy* and communicate this to its bidders, to ensure the EIRRP, and all future development projects, are free of conflict of interest, fraud and corruption which adversely impact on project delivery results. This may be done through appropriate training mediums in collaboration with ADB and other development partners, and internalized, much in line with the sentiments outlined in the *Afghanistan National Development Strategy*.

E. Asset Inspection

60. The Loan Agreement requires that goods and services financed out of the loan proceeds are used exclusively for the Project.⁴⁸ It also requires that the EIRRP be carried out in accordance with sound administrative, financial and operational practices.⁴⁹

61. The Audit Team conducted a field mission in order to verify construction works in October 2008. 13 project sites visited (covering 12 contracts) were visited along the following routes:

- Kabul – Pulekhumri – Aibak – Khulm – Samangan - Mazar
- Mazar – Naibabad - Hairatan return
- Mazar – Bulkah – Shebergan – Ankly return
- Mazar – Dawlatabad – Nauri-Shahi – Bulkh return
- Mazar – Balkh – Samarqandyan – Saripul return
- Mazar – Khulm - Aibak – Samangan – Pulekhumri - Kabul

⁴⁸ Section 3.01-3.05

⁴⁹ Section 4.01(a)

62. The Audit Team are pleased to conclude that overall, the EIRRP generally utilized loan proceeds for agreed intended purposes. Assets were in the appropriate locations and used for the purposes as intended by the Loan Agreement.

63. However, there were considerable implementation delays experienced, and it was observed that gas and irrigation-related contracts were generally less well managed. There were instances of sub-standard material being used and sub-standard work, indicating inadequate project supervision and a deviation from specifications agreed upon.

Recommendation

64. While cognizant of the difficult security situation in the area, it is strongly recommended that the relevant project implementation units in charge

- actively monitor contracts in progress in order to ensure materials and work are at agreed standards, and
- hold the contractor and/or consultant accountable to meet agreed specifications and other contractual requirements.

65. The executing agency should

- focus on improving project management particularly in relation to on-going gas and irrigation-related contracts.

IV. CONCLUDING COMMENTS

66. The Audit Team acknowledges that the early years of the EIRRP were particularly challenging times for Afghanistan. In the meantime, the country has made great strides in rebuilding the country, although much more work is needed. The *Afghanistan National Development Strategy* is a vital statement that indicates the GoA's commitment to rebuilding the nation in accordance with policies and principles that contribute to achieving intended development results.

67. It is clear, however, that there have been significant lapses in project management, which contribute to the overall impression that EIRRP contracts may not have been competitively procured. At worst, EIRRP contracts could be compromised by acts of fraud and corruption. The responsibility for this lies with the GoA.

68. On ADB's part, there appears to have been a significant lack of project oversight. Strong oversight would have undoubtedly identified crucial lapses in achieving project milestones, which if addressed promptly, would have provided greater assurance that EIRRP funds were utilized with integrity in accordance with ADB's terms and conditions. Responsibility of the EIRRP initially resided at the Afghanistan Resident Mission; however it appears that this responsibility was transferred this year to ADB Headquarters. In practice, however, indications are that it remains unclear where supervisory responsibility resides.

Recommendation

69. Central Western Asia Department, the operations department responsible for ADB-funded projects in Afghanistan

- needs to clarify responsibilities, priorities and roles in relation to its oversight function over the EIRRP, and indeed, future ADB-funded projects in Afghanistan,⁵⁰
- must address the absence of a Project Coordination Unit and if it is determined that one is not required, provide justification for the changed structure and initiate the necessary modifications to loan covenants. This clarifies covenants that ADB expect the project and country to comply with, and mirrors actual practice.
- must conduct regular and active monitoring to ensure that loan covenants required for future ADB-funded projects in Afghanistan are well considered in terms of practicality and anticipated benefits to the project, and ensure regular and active monitoring of compliance with such covenants throughout the life of the project.

⁵⁰ Subsequent to the issuance of the first draft report, CWRD on 19 December 2008 approved the implementation of joint portfolio management of AFG projects by AFRM and HQ to strengthen overall oversight function over the entire AFG portfolio.