

ASIAN DEVELOPMENT BANK



**PROJECT PROCUREMENT-RELATED AUDIT REPORT
LOAN 1726-KGZ(SF):
AGRICULTURAL AREA DEVELOPMENT 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
December 2008**

CURRENCY EQUIVALENTS
(as of 31 October 2007)

Currency Unit	=	Kyrgyzstan Som (KGS)
KGS1.00	=	\$0.028653
\$1.00	=	KGS 34.00000

ABBREVIATIONS

ADB	-	Asian Development Bank
BER	-	bid evaluation report
BOQ	-	bill of quantities
COA	-	Chamber of Accounts of Kyrgyz Republic
CWRD	-	ADB's Central and West Asia Department
DP	-	direct purchasing
EA	-	executing agency
ICB	-	international competitive bidding
IS	-	international shopping
KAFC	-	Kyrgyz Agricultural Finance Corporation
KYRM	-	ADB's Kyrgyzstan Resident Mission
LCB	-	local competitive bidding
LFIS	-	ADB' Loan and Grant Financial Information Services
MAWRPI	-	Kyrgyzstan Ministry of Agriculture, Water Resources, and Processing Industry
OAGI	-	ADB Office of the Auditor General, Integrity Division
PMU	-	project management unit
PPRA	-	project procurement-related audit

NOTE

In this report, \$ refers to US dollars.

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EXECUTIVE SUMMARY

1. The Office of the Auditor General, Integrity Division (OAGI) conducted a project procurement-related audit (PPRA) on Asian Development Bank (ADB) Loan 1726-KGZ(SF): Agriculture Area Development Project (Project) from March to August 2008 jointly with the Chamber of Accounts (COA) of Kyrgyz Republic, and a team of consultants assisting.¹ This report documents findings and makes recommendations as a result of the PPRA.
2. The long-term development goal of the Project is to increase the incomes of farmers in Chui Oblast while the immediate Project objective is to increase farm productivity and profitability in selected areas. The Project was designed to fully benefit an estimated 8,000 households and another 2,600 to a lesser extent. This Project supports the Government of Kyrgyz Republic (Government) with its policy and institutional reform program in agriculture and rural finance section with a priority to poverty reduction.
3. The Project comprises four components:
 - (i) *Farm Development;*
 - (ii) *Drainage and Irrigation;*
 - (iii) *Development of Private Sector Marketing and Input Supply Services;* and
 - (iv) *Project Management.*

The Project also includes a medium-term credit line of \$10 million for farm investment loans, which is administered by the Kyrgyz Agricultural Finance Corporation (KAFC – now renamed Aiyl Bank).

4. The PPRA team (Audit Team) reviewed the Project's procurement and disbursement documentation, inspected selected goods and works, evaluated the reasonableness of contract prices, performed a detailed review of the financial management system and credit facility, and conducted conflict of interests check. The main PPRA objective is to identify and reduce internal control weaknesses that may allow fraud, corruption, or abuse to occur in ADB-financed projects and impair development effectiveness.²

Major Recommendations

5. The key recommendations are
 - for the project management unit (PMU) to strictly comply with ADB's procurement guidelines and significantly strengthen internal controls over procurement; and
 - for ADB's operations department (i.e., Central and West Asia Department [CWRD] and Kyrgyz Resident Mission [KYRM]) and the Government to work together to ensure that procurement integrity and transparency are established at the commencement of every development project.
6. Strong procurement and financial management controls mitigate the risk of improper use of Project funds and assets, maximize development effectiveness,³ and deter fraud and

¹ OAGI staff members, a representative from the Chamber of Accounts of Kyrgyzstan, and consultants from TSIAR-FINANS of Uzbekistan comprised the Audit Team.

² ADB. 1998. *Anticorruption Policy*. Manila. para. 67.

³ Note that comments on development effectiveness throughout this report are limited to audit observations as to how recommendations made here - with respect to anticorruption measures, strong internal controls and compliance with applicable guidelines - can increase development effectiveness, and are not intended as comments on the overall development effectiveness of the project.

corruption. The executing agency (EA) must take the lead in addressing this promptly, and collaborate with ADB to strengthen Kyrgyz Republic's capacity to manage for development results.

Results in Brief

7. *Credit Facility:* The Audit Team concluded that the Project funds for the credit facility were used for their intended purposes. Sample subloans financed under the credit facility were generally well organized and managed. Kyrgyz Agricultural Finance Corporation (KAFC – now renamed Aiyl Bank) maintained good financial and credit management records.

8. *Financial Management:* The Project generally used ADB's funds for the intended purposes, and the PMU maintained good financial records based on the sample Project disbursements (71%) the Audit Team reviewed. A few minor financial management weaknesses were noted.

9. *Procurement:* The Audit Team inspected 95% of the total awarded contracts and identified irregularities in the procurement process and instances of non-compliance with ADB's Procurement Guidelines. Weak institutional capacity and limited experience of the PMU in understanding ADB's guidelines may have contributed to the irregularities the Audit Team identified. OAGI will further investigate these in accordance with its *Integrity Principles and Guidelines*, and seek the cooperation of the EA and Project staff at all levels in this effort.

10. *Asset Inspection:* For goods and equipment, the Audit Team confirmed that the sample assets inspected were overall in good condition and utilized as intended. For civil works, numerous contracts were found to have changes in the scope without ADB's approval.

11. *Contract Price Analysis:* For goods and equipment, the contract prices were generally reasonable. For civil works, cost estimates for construction materials prepared during the design stage of the Project were not updated to reflect the high inflation rates especially when the duration between the dates of cost estimates and start of construction was long.

12. *Conflict of Interests check:* The company profile checks on 15 selected contractors and suppliers/vendors reveal no instances of conflict of interest with the Project's personnel.

Final Comments

13. Despite weaknesses noted in the Project procurement management and administration, there are positive indications that the outputs delivered appear to be satisfactory to the beneficiaries and have improved the income of farmers. It is noteworthy that during our asset inspection and credit facility fieldwork, the Audit Team did not receive negative feedback from beneficiaries. The credit line funds were highly demanded by the farmers and agribusinesses. The Audit Team quantity surveyor noted that quality of civil works meets the national and regional standards. However, the maintenance of rehabilitated irrigation and drainage under PPRA sample needs improvement.

14. Overall, the Project seems to be able to achieve its desirable outcome based on the delivery of awarded contracts. Implementation of recommendations made in this report can only augment results achieved to date.

15. The Audit Team thanks Project management and staff especially the PMU team, KAFC team, Kyrgyzstan Ministry of Agriculture, Water Resources, and Processing Industry (MAWRPI – originally Ministry of Agriculture and Water Resources), Chui Oblast Administration, as well as CWRD and KYRM for their cooperation and assistance to audit requirements. ADB values the courtesy and support the Project officials extended to the Audit Team, including the valuable participation of COA who jointly conducted this PPRA.

I. PROJECT BACKGROUND

1. The Kyrgyz Republic is predominantly a rural economy with more than 65 percent of the population living in the rural areas. Loan 1726-KGZ(SF): Agriculture Area Development Project (Project), approved by the Asian Development Bank (ADB) on 20 December 1999¹ is ADB's third project in agriculture and rural finance. The long-term development goal of the Project is to increase the incomes of farmers in Chui Oblast while the immediate Project objective is to increase farm productivity and profitability in selected areas. Chui Oblast was selected for its significant economic potential in agricultural growth and development as well as its importance to the economy. The Project is intended to fully benefit an estimated 8,000 households and another 2,600 to a lesser extent.

2. The total Project costs around \$45 million and ADB is financing \$36 million. The Project comprises four components: (i) *Farm Development*; (ii) *Drainage and Irrigation*; (iii) *Development of Private Sector Marketing and Input Supply Services*; and (iv) *Project Management* supporting logistic requirements and operational expenses of the Project Management Unit (PMU). The Project also includes a medium-term credit line of \$10 million for farm investment loans, which is administered by Kyrgyz Agricultural Finance Corporation (KAFC – now renamed Aiyl Bank).

3. The Ministry of Agriculture, Water Resources, and Processing Industry (MAWRPI) is the Project's executing agency (EA) and is responsible for the overall coordination of the Project. PMU is responsible for the day-to-day project implementation and reports regularly to the Chui Oblast Administration.

4. The Project Steering Committee, chaired by the Minister of MAWRPI and co-chaired by the Governor of Chui Oblast, acts as the oversight body and is responsible for (i) providing guidance to the PMU on issues related to policy; (ii) monitoring overall Project progress and its consistency with the Project's objectives; and (iii) facilitating activities between the Project and other existing related projects.

5. The Government of the Kyrgyz Republic (Government) recognized the importance of the rising poverty situation by declaring 1998 as the Year of Rural Development and Poverty Reduction, and continues to take steps to reduce the level of poverty. This Project supports the Government's policy and institutional reform program in agriculture and rural finance and serves as a foundation for economic growth with poverty reduction.

II. AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

6. The overall PPRA objective is to help prevent and detect fraud and corruption as defined under ADB's anticorruption policy.² Corrupt behavior is a serious impediment to the development process, severely reducing development effectiveness and jeopardizing successful delivery of development benefits. The anticorruption policy along with *Procurement Guidelines*³ and *Guidelines on the Use of Consultants by Asian Development Bank and its Borrowers*⁴ require all parties to ADB-financed activities (including borrowers, beneficiaries,

¹ The Loan Agreement between the Kyrgyz Republic and ADB is dated 16 May 2000.

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

³ ADB. 2004. *Guidelines for Procurement under Asian Development Bank Loans*, Manila

⁴ ADB. 2005. *Guidelines on The Use of Consultants by Asian Development Bank and Its Borrowers*, Manila

bidders, suppliers, and contractors) to maintain the highest ethical standards for ADB-financed activities.⁵

7. The anticorruption policy prohibits fraudulent and corrupt practices in ADB-financed operations and defines

- a *corrupt* practice as the offering, giving, receiving or soliciting, directly or indirectly, anything of value to improperly influence the actions of another party;
- a *fraudulent* practice as any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit to avoid an obligation;
- 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; and
- a *collusive* practice as an arrangement between two or more parties designed to achieve an improper purpose, including influencing improperly the actions of another party.⁶

8. In addition, *conflict of interest* may contribute to or constitute a prohibited practice under the anticorruption policy. It is defined as a situation in which a party has interests that could improperly influence that party's performance of official duties or responsibilities, contractual obligations, or compliance with applicable laws and regulations.⁷

9. The PPRA is intended to:

- identify whether the procurement of project goods, works and services complied with ADB's Procurement Guidelines and the Loan Agreement;
- determine whether project contracts were implemented according to the terms,
- 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 this project and future ADB-financed projects.

10. PPRAs are conducted in line with ADB's efforts to manage for development results. PPRAs 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. PPRAs thus contribute to ensuring ADB-financed projects are managed to produce intended development results.

11. To achieve the audit objectives, the Audit Team conducted fieldwork at the PMU and

- reviewed the Project's procurement and disbursement documents;
- evaluated the Project's procurement processes, internal controls and financial management practices;

⁵ Paragraph 48, *Integrity Principles and Guidelines (November 2006)*; 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)*.

⁶ Paragraph 2, *Integrity Principles and Guidelines (November 2006)*.

⁷ Paragraph 50, *Ibid.*

- inspected the Project's goods procured and works completed at selected Project sites;
- conducted a review of the credit facility at Aiy Bank and the related activities;
- performed conflict of interest checks; and
- assessed the reasonableness of contract prices.

12. A major challenge to this audit was that the PMU's Project Manager was replaced and the key Procurement officer resigned and moved to another project right before the PPRA, which interrupted and delayed the audit process. While the PMU team was helpful, they were not familiar with the Project's procurement activity, nor were they able to timely locate key tendering documents during the audit fieldwork. The Audit Team had to elevate the concerns to the Ministry of Finance (MOF), MAWRPI, and ADB's Kyrgyz Resident Mission (KYRM) to seek support for the procurement officer to return to the PMU during the fieldwork. The Audit Team appreciates the procurement officer's cooperation to help locate procurement files and address questions after the exit conference.

13. The Audit Team reviewed 69 contracts amounting to \$24.3 million or 95% of the total awarded contracts (\$25.5 million) as of 31 October 2007.⁸ These were awarded through international competitive bidding (ICB), local competitive bidding (LCB), international shopping (IS), and direct purchase (DP).

14. The Audit Team also evaluated the portfolio under the credit line through KAFC and reviewed 100 sub-loans aggregating KGS 33.5 million (\$1 million) or 8% of the total outstanding credit as of 31 October 2007 to assess the Project's credit facility.

15. The Project's financial management was also assessed through a review of 1,576 transactions relating to 171 contracts⁹ or 93% of the 183 contracts awarded as of 31 October 2007. In terms of value, this accounts for \$10.5 million or 71% of the total amount disbursed for the sampled contracts as of 31 October 2007 as tabulated below.

Category Ref. No.	Category Name	No. of Reviewed Contracts	Contract Amounts (\$)	Disbursed Amount (\$)	Amount of Sampled Contracts (\$)	Amount of Disbursements Reviewed (\$)	% Reviewed
1	Civil Works	55	16,393,140	8,522, 117	8,522,117	6,223,731	73.0%
2	Supply of Goods	32	1,946,634	41, 918,949	1,862,896	1,682,498	87.7%
3	Training	31	2, 266,556	1,178,033	813,836	742,880	63.1%
5	Consultancy	28	3,750,265	2,577,429	2,353,839	1,578,034	61.2%
6	Operating costs	80	2,520, 999	517,345	313,588	239,951	46.4%
TOTALS		226	26,877,594	14, 713,873	13,866,276	10,467,094	71.1%

⁸ 31 October 2007 was the cut-off date for the PPRA samples.

⁹ One sample contract may cover a number of categories.

III. AUDIT FINDINGS AND RECOMMENDATIONS

16. The PPRA results are summarized into six categories: (i) Credit Line Management, (ii) Financial Management System; (iii) Project Procurement Process; (iv) Asset Inspection, (v) Contract Price Analysis, and (vi) Conflict of Interest Check.

A. Credit Line Management

17. The Audit Team reviewed the Project's credit-line process and credit files and concluded that the sub-loans financed under the credit facility are generally well documented and used for their intended purposes, except for two minor deviations. The credit line funds were highly demanded by the farmers and agribusinesses.

18. Sub-borrower's reports on the use of funds, KAFC's monitoring reports, and Audit Team's asset verification results further confirmed proper utilization of the sub-loans under selected samples.

B. Financial Management System

19. The Loan Agreement requires the Borrower to ensure that the Project is carried out with due diligence and efficiency, and in conformity with sound administrative, financial, engineering, environmental, and agricultural practices.¹⁰

20. The Audit Team examined the PMU's financial management systems and existing internal controls and found that these were generally adequate. The Audit Team, however, observed the following instances that are not in compliance with the Loan Agreement, Project Agreement and/or ADB disbursement guidelines:

1. Inappropriate Computation and Reporting of the Borrower's Contribution to the Project

21. The Government made in-kind contribution to the Project in the form of taxes and duties, as well as operations and maintenance of off-farm irrigation and drainage system. ADB, MAWRPI, and MOF agreed that applicable tax rates, particularly 20% VAT and 4% sales tax (i.e, approximately 20% of the sum of goods, services, VAT, and sales taxes) shall be applied in accordance with the agreed method of computations.¹¹ It was also agreed that stakeholders' in-kind contribution, including that of KAFC and the Water User Associations (WUA)¹² will not be recorded in the project accounting system but shown as a footnote in the Summary of Sources and Uses of Funds.¹³

22. The agreed computation for in-kind contributions was formulated under the assumption that sales tax is paid in addition to the VAT. However, the Audit Team noted that sales taxes were not reflected in the bills, invoices and other source documents issued by the contractors

¹⁰ Section 4.01 of the Loan Agreement between the Kyrgyz Republic and ADB dated 16 May 2000.

¹¹ The estimated rate of 20% rate is computed as follows: VAT: $100 \times 1.20 = 120$; Sales Tax: $100 \times 1.04 = 104$; therefore total contribution equals 19.4% [$24/124 \times 100 = 19.4\%$] or approximately 20%

¹² Aiyl Bank's contribution comprise of working capital finance and staff salaries to operate the credit facility while WUA's are O&M for on-farm drainage and irrigation system.

¹³ The method of calculation and reporting of in-kind contributions from the Government, Aiyl Bank, and Water User Associations (WUA) was agreed per Aide Memoire dated 4 December 2002, and formalized in ADB's approval letter of 17 March 2003.

and suppliers, and thus sales taxes were not imposed on top of 20% of VAT. As a result, the in-kind contribution computed based on the agreed formula has been overstated. While the in-kind contribution is not an actual budget contribution to the Project and it should not impinge on the Project outputs, the amount of estimated contribution from the Government reported in the yearly Project reports is overstated.

2. Misclassification of Disbursements/Expenses

23. The Audit Team determined that contracts awarded for design works for two farms were classified under “*Consulting Services*” instead of “*Civil Works*” in ADB’s Loan and Grant Financial Information Services (LFIS).

24. The Audit Team also noted several instances where consulting services (\$5,948), operating expenses (\$38,997), and items such as office repair works, audit services, postal services, and export market research business trips were misclassified to “*Equipment*”. ADB’s Central and West Asia Department (CWRD) explained that ADB merged the expenditure account such as materials and services with other expenditures such as equipment and machinery. Thus, it was not a misclassification by the PMU, but it is a classification issue within ADB’s database.

3. Payments from the Imprest Account Exceeded the Ceiling

25. The Audit team identified eight instances where payments under various contracts aggregating to \$240,796 exceeded the applicable limit on disbursements from the Imprest Account.¹⁴ However, the Audit Team learned that the Controller’s Department validated the source documents before releasing these payments.

4. Ineligible Reimbursement to Contractor

26. The Audit Team noted one instance where a contractor was reimbursed for \$300 per diem expenses which occurred prior to the awarding of a contract. Although the advance payment was reimbursed after the contract was awarded, this is a pre-bid expense which should not have been charged to the Project.

5. Inappropriate Supporting Documents

27. The Audit Team identified the bills of quantities under four civil works contracts contain hand-written corrections. Propriety of such alterations could not be established because neither were original bills of quantities available, nor were any explanations documented for such changes.

28. Certain source documents were incomplete when the Audit Team tried to substantiate expenditures. For example, a patent tax certificate was issued a firm and submitted by another firm to certify payment for repair works under two liquidation reports has no stamp from the Kyrgyzstan tax authorities to establish that the supplier is an authorized provider. Also, one liquidation report does not bear the name of the staff liquidating the cash advance.

¹⁴ \$25,000 is the limit applicable for the period reviewed. This ceiling was increased to \$100,000 effective 26 May 2006.

6. Charging of Local Taxes from ADB funds

29. The Audit Team noted three instances where local taxes aggregating KGS 9,140 or approximately \$223 were charged to ADB funds. These are expenditures reimbursed under three contracts.

7. Erroneous Posting of Disbursements in LFIS

30. The Audit Team noted nine instances where ADB posted the disbursements to the incorrect contract numbers in LFIS.

Recommendations

31. The Audit Team recommends that the PMU

- improve the chart of accounts to minimize inconsistencies in allocation to relevant expense categories;
- gain a better understanding of ADB's reimbursement procedures, especially on eligibility requirements for ADB financing and SOE prescribed ceilings; and
- correct the local tax erroneously billed to ADB.

32. The Audit Team also recommends that CWRD correct the errors in LFIS, review the accuracy of Project data in LFIS periodically, and request the PMU to regularly reconcile the Project records with ADB's.

C. Project Procurement Process

33. The Audit Team identified a number of irregularities in the procurement process. The irregularities in relation to possible nepotism, potential collusion among bidders, and questionable bid evaluations, signify that ADB's anticorruption policy may have been violated. To determine if this is the case, OAGI will investigate these irregularities subsequent to completion of the PPRA in accordance with ADB's *Integrity Principles and Guidelines*. Violations to the anticorruption policy invariably results in ineffective and/or improper use of aid funds, thereby reducing development effectiveness.

1. Indicators of Possible Fraud and Corruption

34. *Nepotism:* ADB Procurement guidelines require that specifications of procured goods shall be based on performance requirements, and reference to brand names, catalogue numbers or the like shall be avoided unless deemed necessary to ensure inclusion of certain essential features. In such case, the reference shall be followed by the words "*or equivalent*" and the specifications shall permit offers of alternative goods which provide performance and quality at least equal to those specified.

35. The Audit Team noted the use of a specific brand name in the technical specifications in the bid invitation for procurement of drainage equipment which is identifiable to the winning bidder. The winning bidder was also the sole participating bidder for this bid. The Audit Team also noticed that the bidder requested the bidding documents prior to the bid advertisement. In addition, the bidder shouldered the expenses of three PMU representatives for visiting its place of business. The international consultant who prepared the bid invitation explained that the

early request from the winning bidder may have stemmed from a verbal advice to potential suppliers declaring release of bid advertisement sometime in December 2002 or January 2003.

36. *Similar bid prices:* The Audit Team found three instances where the contract price was several times higher than project cost estimate. In one contract, the initial bidders refused to extend the validity of their proposals due to sudden increase in prices of the raw materials, and the re-bidding resulted in award of the contract at price 2.8 times higher than initial cost estimate. The price for another contract was 2.3 times higher than cost estimate, while the bid price difference among 3 participating bidders was less than 3%. The price for a third contract was 2.2 times higher than cost estimate, while the bid price difference among 3 participating bidders was less than 7%.

37. Similar bid prices may signify possible collusion among bidders. However, it should be noted that the PMU did consult ADB and negotiated with the most responsive bidders for the three contracts in question before awarding these contracts.

38. *Ineligible bidders not disqualified:* The Audit Team found 10 bid submissions that were either not signed, dated or with incomplete and conflicting dates, but were not disqualified.

39. *Questionable bid evaluations:* ADB's Procurement Guidelines require that bid evaluation must be consistent with the method, terms and conditions set forth in the bidding documents. Apart from price, other relevant factors such as the efficiency of the equipment shall be taken into account in determining the lowest responsive bid to the extent and in the manner specified in the bidding documents. The Audit Team noted that in the bid for office equipment for WUA, the technical specifications for computers per bid document required Pentium IV microprocessor, but the contract was awarded to a bidder who proposed computers with Celeron microprocessor, which is slower in processing speed compared to Pentium IV.

40. *Undefined technical specifications:* ADB's Procurement Guidelines indicate that it is essential that the bidding documents provide all the information necessary for bidders to prepare responsive bids. The Audit Team noted that technical specifications and related requirements were not clearly identified in the bid documents but were applied during evaluation. The technical specifications for the purchase of a copier were not clearly defined in the bidding documents, hence bidders proposed copiers with different capacities. In the same bid, the contract award basis – by lot or by item – was also not specified.

2. Deviations from ADB's Procurement Guidelines

41. *Delays in bid opening:* The Audit Team noted delays in opening of the bid proposals for six contract packages, ranging from 1 to 30 days. The PMU attributed such delays to turnover in key Project officials and lack of quorum in the bid committee.

42. *Incomplete bid evaluation committee:* The Audit Team observed one instance where members of the bid evaluation committee were officially designated only after the bid opening. The Audit Team also noted four instances where only two of the five-member bid committee signed the minutes of the technical evaluation, for which ADB has cautioned the PMU many times. PMU explained that these instances were caused by frequent replacement of government officials in MAWRPI and other ministries.

43. *Invalid performance guarantees:* The Audit Team noted that the performance guarantees provided by the contractors for three contracts did not cover the entire contract period.

44. The Audit Team also noted one instance where the posted performance security was less than the requirement. In one contract, the performance security amounting to \$12,560 was 3.6% of the contract amount (VAT exclusive), while requirement is 5%. The PMU explained that this happened due to computational errors by PMU staff.

45. *Long delays in awarding contracts:* The Audit Team also noted delays in the awarding of contracts. On 20 instances, contracts were awarded to the winning bidders within 4 to 10 months from bid proposal dates, registering delays of 1 to 7 months from the reasonable 90-day period. The PMU explained that obtaining ADB's approval was the main reason for the delays.

46. The Audit Team found one instance where the contract was awarded prior to obtaining ADB approval. The contract was awarded on 27 November 2006, while the ADB approval was secured on 12 April 2007. Per PMU, verbal approval was obtained from ADB prior to contract signing.

3. Missing Documents

47. Some of the required procurement-related documentation was unavailable for audit review during the fieldwork. A number of documents related to the procurement process could not be located at the time of the audit fieldwork. While the Project documents were provided after the exit conference, this is a restriction to the scope of the audit. For the contracts affected, the Audit Team was unable to adequately evaluate if the bid process complied with ADB's *Procurement Guidelines*, and other relevant guidelines, and if these were conducted in line with ADB's anticorruption policy. The late submission of documents affected 31 of 69 sample contracts.

Recommendations

48. To provide the individuals involved in bid evaluation with adequate support and to ensure due diligence on their part, it is recommended that CWRD

- continue advising the PMU and ensure that the PMU exercises due diligence in evaluation of bid proposals and quotations, while strictly observing applicable bidding procedures; and
- identify and augment appropriate training on procurement matters directed toward key procurement staff in order to improve capacity in this area.

49. It is recommended that the EA, through the PMU

- assist and support OAGI in the future review of irregularities identified through this PPRA.

50. Deviations from ADB guidelines may result in unfair procurement practices and non-competitive bidding. Non-compliance may also increase the incidents of undetected fraud and corruption. It is recommended that for future contracts, the PMU

- strictly follow the bid opening dates;

- ensure validity of performance guarantees; and
- implement a document register to systematically record the contents and movements of project documents to improve accountability and reduce the incidence of misplaced documents.

and that CWRD

- establish if there were any special circumstances leading to these deviations, and institute checks and balances as necessary.

D. Asset Inspection

51. The Loan Agreement requires that goods financed out of the loan proceeds are used exclusively for the Project.¹⁵ It also requires that Project facilities are operated, maintained and repaired in accordance with sound administrative, financial, maintenance and operational practices.¹⁶ The Audit Team with the quantify surveyor's assistance selected 22 contracts, including 14 civil works and 8 goods and equipment related contracts for asset inspection.

1. Goods and Equipment are in Order

52. The Audit Team confirmed the existence of the Project goods and equipment and found them generally were in accordance with the contract terms except for minor deviations noted in the specifications of goods and equipment for one contract.

53. Specifically, one vehicle has no front airbags, and another vehicle was supplied with a 2.7- valve engine instead of a 3.3-valve, without air condition and central lock. There were no user manuals in Russian language provided for the two vehicles and for another vehicle. The Audit team noted that such deficiencies were stated in the receipt of acceptance. However, no explanations were documented nor price reduction was made to compensate for these deficiencies. The PMU explained that the vehicle factories did not offer these features, but other parameters met the Project's technical specifications.

54. The Audit Team also found that beneficiaries were not using some of the procured equipment, such as chemical treatment equipment and flail mowers. The beneficiaries explained that the chemical treatment equipment was hardly being used due to the high price of chemicals. Flail mowers were not used because of the uneven surfaces of side slopes of the canals in Kyrgyzstan. The PMU indicated that these mowers would be used for maintenance collectors on smooth roads.

2. Civil Works Contain Unreported Scope Changes

55. The Loan Agreement stipulated that the Borrower shall carry out the Project in accordance with agreed plans, design standards, specifications, work schedules and construction method and shall furnish ADB, *promptly after their preparation*, such documents, and any material modifications subsequently made therein, and such details as ADB reasonably requests.¹⁷ The Audit Team identified nine civil work contracts with changes in the scope of

¹⁵ Section 3.04

¹⁶ Section 4.09

¹⁷ Art 4.02 (b) of the Loan Agreement

work. The scope modifications were, in all cases, performed without ADB notification and/or prior approval.

56. The Audit Team noted that supporting documents for changes in the scope of civil work contracts were unavailable with PMU. Reproduced documents such as new design drawings and bill of quantity variations were obtained from the design institute on 19 May 2008 at the request of the Audit Team. Design changes for on-going contracts were unavailable with the PMU and were allegedly with contractors at the time of the audit. The PMU explained that the Project Coordinators are entitled to change scope of work that is less than 15% of the bill of quantity without ADB's approval. However, the absence of supporting documents hindered the ability of the Audit Team to establish the extent of the changes made to the original design, and reasonableness of the actual costs disbursed.

Recommendations

57. The Audit Team recommends that

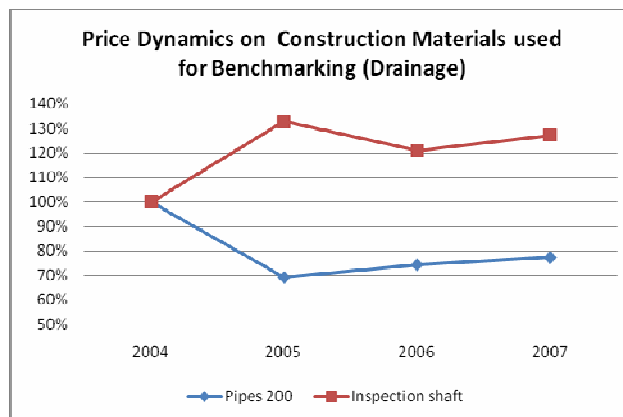
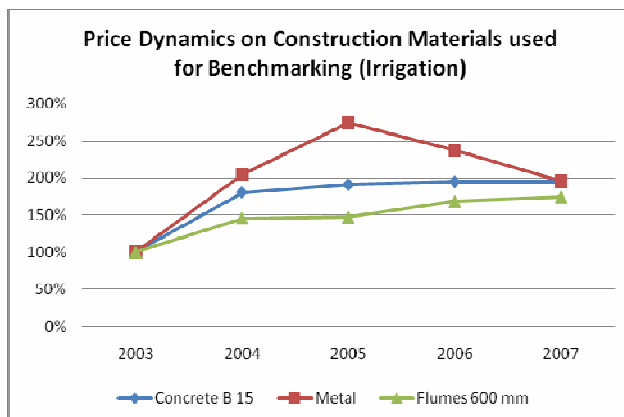
- CWRD reviews the modifications to the Project's civil work contracts and evaluate if there were unusual circumstances causing the PMU not to inform ADB of the scope changes; and
- PMU strictly complies with contractual terms and inform ADB of scope changes in contracts. PMU should provide adequate justification and obtain ADB's approval for any significant changes in the scope of contract.

E. Contract Price Analysis

58. The Audit Team compared the Project prices on selected goods and equipment with the market prices appropriately adjusted based on the contract terms and concluded that the Project goods and equipment were generally procured at reasonable prices.¹⁸

59. The Audit Team also selected 16 civil work contracts and compared the Project contract prices with the market prices. The Audit Team noted that construction cost estimates prepared during the design stage of the Project were not updated for comparison with contractors' bidding prices due to high inflation rates and the long period between the dates of cost estimates and start dates of construction. The bidders usually include price contingencies for high inflation, resulting to the contract being awarded at prices several times higher than initial cost estimate in some cases as depicted in the analyses below.

¹⁸ The Audit Team was unable to verify prices on specialized drainage equipment procured under four contracts because no comparable prices were readily available in the market.



Recommendation:

60. It is recommended that the EA review cost estimates developed during the Project design stage and consider updating the estimates if pricing factors have changed significantly before the bidding process begins.

F. Conflict of Interest

61. The company profile checks on 15 selected contractors and suppliers/vendors to whom the sampled contracts were awarded reveal no instances of conflict of interest with the project personnel based on the listed owners and directors in each of the companies. Checks on 15 sub-borrowers who utilized credit facility also showed no conflict of interest with KAFC's approving officers/personnel.

IV. CONCLUDING COMMENTS

62. Greater collaboration may be required between CWRD and the Government to establish a more effective review and monitoring mechanism for future projects in Kyrgyz Republic to ensure transparent procurement and contracts execution. Timing and staffing of ADB review missions are crucial to the success of ADB projects and should be carefully planned and executed to help maximize the impact on development results.

63. The procurement irregularities and scope modification on civil work contracts at the PMU are of concern. It is important that irregularities including non-compliance instances identified here do not recur in future and similar projects in the Kyrgyz Republic.

64. Despite weaknesses noted in this Project procurement management and administration, there are positive indications that the outputs delivered appear to be satisfactory to the beneficiaries and have improved the income of farmers. It is noteworthy that during our asset inspection and credit facility fieldwork, the Audit Team did not receive negative feedback from beneficiaries. The credit line funds were highly demanded by the farmers and agribusinesses. The Audit Team quantity surveyor noted that the quality of civil works meets the national and regional standards. However, the maintenance of rehabilitated irrigation and drainage under the selected samples needs improvement. Overall, the Project seems to be able to achieve its desirable outcome based on the delivery of awarded contracts.

65. It is crucial that bidding integrity and transparency are established at project commencement, as this is when material, large contracts are often awarded, and the opportunity to maximize development effectiveness and results is greatest. More comprehensive field review/inspection missions, conducted at regular intervals and composed of staff with multi-disciplinary skills, will be helpful to provide on-site guidance to the Project officials.