

ASIAN DEVELOPMENT BANK



**PROJECT PROCUREMENT-RELATED AUDIT REPORT
LOAN 1998-MON(SF):
SECOND HEALTH SECTOR 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

(on 26 November 2008)

Currency Unit	-	Tugrik
1.00 Tugrik	=	\$0.0008572653
\$1.00	=	1,166.50 Tugriks

ABBREVIATIONS

ADB	-	Asian Development Bank
DMC	-	developing member country
DP	-	direct purchase
EA	-	executing agency
EARD	-	East Asia Department
ICB	-	international competitive bidding
IS	-	international shopping
LCB	-	local competitive bidding
MDG	-	Millennium Development Goals
MNRM	-	Mongolia Resident Mission
MOF	-	Ministry of Finance
MOH	-	Ministry of Health
NCB	-	national competitive bidding
OAGI	-	Office of the Auditor General, Integrity Division
PIU	-	project implementation unit
PPRA	-	project procurement-related audit
RETA	-	regional technical assistance
<i>aimag</i>	-	province
<i>soum</i>	-	district

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. 1998-MON(SF): Second Health Sector Development Project (the Project) carried out in Mongolia. The Project's overall goal is to improve the health of the poor and vulnerable, including women and children, in targeted rural areas of Bayanhongor, Dornod, Hentii, Uvurhangai and Zavkhan *aimags* (provinces). It comprises three components:

- Part A: Integrated Improvement of Rural Health Services;
- Part B: Institutional Capacity Development; and
- Part C: Project Management.

2. Decentralization has become a priority by the Government of Mongolia (Government) for delivering and financing health services. The Ministry of Health (MOH) has shifted to policy development, strategic planning, regulation and standard setting, and monitoring and evaluation. However, the local governments lack experience and planning and managerial capacity in resource allocation in the health sector. If decentralization were to produce the expected positive outcomes, capacity for local governments must be enabled.¹ The Project was designed to help build donor coordination capacity and mechanisms of MOH, and to help create a conducive environment for effective donor assistance.² This is in the spirit of the Paris Declaration on Aid Effectiveness endorsed in 2005 to maximize aid effectiveness and management for development results.

Major Recommendations

3. The key recommendations are

- for the executing agency (EA) to significantly reinforce its bid evaluation process to ensure that only technically qualified bidders are awarded with contracts;
- for the EA to strengthen its internal controls across all levels of project implementation; and
- for ADB's operational department and the Government to work together to ensure that procurement integrity and transparency are established at the commencement of every development project.

4. Strong procurement and financial management controls and compliance with relevant guidelines mitigate the risk of improper use of Project funds and assets, maximize development effectiveness³ and deter fraud and corruption. The EA should take the lead in addressing this promptly, and collaborate with ADB to strengthen Mongolia's capacity to manage for development results.

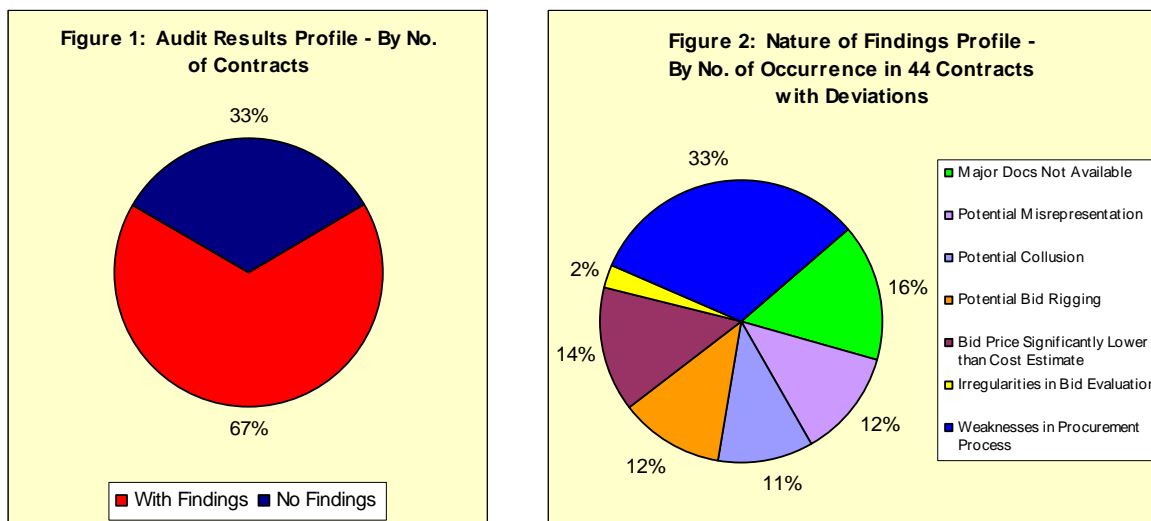
¹ Paragraph 15, *RRP: MON 31242 Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Mongolia for the Second Health Sector Development Project (May 2003)*.

² Paragraph 25, *Ibid.*

³ Note that comments on development effectiveness throughout this report are limited to and based on 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.

Findings and Recommendations

5. Out of the 66 contracts reviewed by the Audit Team, 44 contracts (or 67%) were compromised. Of these, there were 83 procurement-related findings noted by the Audit Team, where one contract may have more than one type of deviation. Figure 1 presents the audit results profile in terms of percentages of contracts with and without findings relating to the procurement process. Figure 2 illustrates the breakdown of the 83 procurement-related findings found in 44 contracts.



Scope Limitation

6. Key bid documents for 13 procurement and consulting contracts were not available for audit review,⁴ which represents 16% of the 83 procurement-related audit observations. This is a restriction to the scope of the audit, in that no conclusive assessment could be made on the integrity and competitiveness of the bid process. Consequently, there is no assurance that loan funds were appropriately used for Project development objectives, or that the procurement process is free from fraud and corruption.

Project's Procurement Process

7. Re-evaluations of proposals were undertaken after notification of the winning bidder and/or contract award. These re-evaluations declared a different winner and resulted to complaints from losing bidders.

8. The Audit Team was not able to validate assessments of bidders' compliance with bid requirements due to lack of supporting documents. In addition, some evaluations were inconsistent with submitted documents or lacking in information to reflect the actual evaluation of bids. These deficiencies indicate lack of thoroughness in the evaluation process, which may have caused awarding contractors with inadequate experience and/or financial capacity, delays

⁴ The list of the audit requirements pertaining to procurement- and disbursement-related documents was provided to the PIU on 17 March 2008, prior to the PPRA planning mission on 1-8 April 2008. The fieldwork was undertaken during the period May up to mid-June 2008.

in contract implementation, including re-evaluations and re-bids. These erode effective delivery of project development objectives. It is recommended that the EA

- revisit the evaluation criteria and sub-criteria, and consider assigning individual scores for each sub-criteria;
- ensure that the Project Implementation Unit (PIU) exercises due diligence in evaluation of bid proposals and quotations, and strictly observes applicable bidding procedures;

and that the East Asia Department (EARD), through the Mongolia Resident Mission (MNRM)

- identify and augment appropriate training on procurement matters directed toward key procurement staff in order to improve capacity in this area.

Asset Inspection

9. Civil works were determined to be generally in line with contract specifications, structure consistent with the design, and utilized as intended. There were, however, defects which included paintings peeling off; leaking ceilings; heating facility smoke pipes broken or not in good condition; wall ceramic tiles used as floor tiles; misaligned windows and doors; toilets not working properly; and clogged water pipes.

10. The Audit Team also determined that there had been lack of trained personnel to operate medical equipment in the *aimags* and *soums* (districts). In addition, most major medical equipment has foreign manufacturers, and the instructions on how to operate the purchased equipment are in a foreign language not understood by relevant personnel. It is recommended that the executing agency

- implement periodic inspection of the Project, and effect immediate repairs, as necessary;
- exercise prudence in awarding subsequent contracts to contractors who did not perform satisfactorily in an earlier contract; and
- ensure that contracts with suppliers of equipment with foreign manufacturers should provide translated brochures and instructions on how to use the equipment, and include training as such.

Fraud and Corruption Indicators

11. There were significant irregularities indicating that fraudulent and corrupt activity may have taken place during the procurement process. These were in relation to potential misrepresentation of income by bidders, possible collusion, possible bid rigging, and potential lowering of bid prices to win contracts. ADB will conduct further investigation of these irregularities in accordance with its *Integrity Principles and Guidelines*, and seek the cooperation of the executing agency and Project staff at all levels in this effort.

Final Comments

12. There were positive indications that the Project has delivered expected outputs to improve rural health service delivery in Mongolia, and should continue to do so. While the project experienced significant delays in implementation, project assets were found to be

generally used as intended by targeted beneficiaries. Implementation of recommendations made in this report can only augment results achieved to date. Lessons learned from this project procurement-related audit should be adapted in the implementation of the Third Health Sector Development Project in Mongolia.

13. The Audit Team acknowledges the responsiveness and cooperation of the Project management to audit requirements. ADB values the courtesy and support that Project officials extended to the Audit Team, including the valuable participation of the Mongolia National Audit Office who jointly conducted this PPRA.

I. PROJECT BACKGROUND

1. Asian Development Bank (ADB) Loan No. 1998-MON(SF): Second Health Sector Development Project (the Project) was designed to improve the health of the poor and vulnerable, including women, children, and the high-risk behavior population in the targeted rural areas in Mongolia. It aims to (i) improve the quality and utilization of health services in the rural areas; and (ii) build the institutional capacity of the health sector based on the reform achievements and institutional developments of the First Health Sector Development Program in sector efficiency, effectiveness and sustainability.

2. The Project was intended to benefit the five *aimags*¹ in the integrated improvement of rural health services component, but will benefit indirectly the whole population in the nationwide components that support health sector reform and sector institutional building. The target rural *aimags* are Bayanhongor, Dornod, Hentii, Uvurkhangai and Zavkhan, which were selected for their level and severity of poverty, levels of infant and maternal mortality, and incidence of infectious diseases.

3. ADB approved the Project loan on 5 June 2003, and the loan became effective on 24 November 2003. The Project costs approximately \$17.50 million of which ADB financed \$14 million (80% of total project cost), and the Government of Mongolia (Government) financed \$3.5 million equivalent.

4. The Ministry of Health (MOH) is the Project executing agency (EA) and is responsible for the coordination of the overall implementation of the Project. MOH is supported by a Steering Committee, *Aimag* Coordinator Posts, and *Aimag* Supervisory Groups to ensure inter-agency coordination and integration of Project implementation. The Project Implementation Unit (PIU) within MOH spearheads the day-to-day coordination and Project implementation, which include, among others, supervising Project construction; providing support for the procurement of equipment and materials; selection, engagement and management of consultants; monitoring and reporting of Project status and progress; and coordinating with ADB and MOH on Project-related matters. The Project was originally scheduled for completion on 31 December 2008. It was subsequently extended to 30 June 2009.

5. The Government has been reforming its health care system and health financing mechanisms since the early 1990s. The health sector in Mongolia had been facing considerable challenges in terms of double burden of diseases, poor rural health sector development, hospital-dominated system, and inefficient hospital management, poor human resources development, limited and inefficient health care financing, people's perceptions and attitudes to health reform, and lack of harmonized international assistance and its limited utilization. The relevant Millennium Development Goals (MDGs) that the country aims to achieve are centered on poverty reduction, child health, maternal health, universal access to reproductive health, adult health, and nutrition.² ADB, through the Health Sector Development Program,³ has been helping the Government plan and implement sector reforms since 1997.

6. Mongolia was the first developing member country (DMC) to enter into a Poverty Reduction Partnership Agreement with ADB, which adopted the MDGs as its strategic goals.

¹ provinces

² Paragraphs 2-25. RRP: MON 31242 Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Mongolia for the Second Health Sector Development Project (May 2003).

³ ADB. 1997. Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Mongolia for the Health Sector Development Program.

To help Mongolia achieve the MDGs, ADB continues to help promote economic growth for job creation and improve provision of essential social services for the poor.⁴ The Project was designed as a core poverty intervention with a focus on human development and gender development, which addresses the focal points of ADB's country strategy and program for Mongolia.

7. Both ADB and Mongolia subsequently endorsed the *Paris Declaration on Aid Effectiveness, 2005*. Through this declaration, both ADB and Mongolia undertake to work together in a participatory approach to strengthen institutional capacity and manage for development results. Mongolia was one of the first DMCs for which ADB formulated a results-based country strategy and program.⁵ Regional technical assistance (RETA) projects were provided to improve Mongolia's understanding and results orientation of sector management processes for education and health in a decentralized context.⁶ The Project is geared towards maximizing effective delivery of intended Project benefits to Mongolia's poor and vulnerable, including women and children, in the rural areas.

II. AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

8. The overall PPRA objective is to help prevent and detect corruption and fraud as defined under ADB's anticorruption policy⁷ to maximize development results and benefits to the poor. Corrupt behavior is a serious impediment to the development process, severely reducing development effectiveness and jeopardizing successful delivery of development benefits. This policy, along with the *Procurement Guidelines* and *Guidelines on the Use of Consultants by Asian Development Bank and its Borrowers* require all parties to ADB-financed activities (including borrowers, beneficiaries, bidders, suppliers, and contractors) to maintain the highest ethical standards for ADB-financed activities.⁸

9. 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

⁴ ADB. 2003. *Mongolia Country Strategy and Program Update (2004-2006) (15 August 2003)*

⁵ ADB. 2005. *Country Strategy and Program (2006-2008) for Mongolia*.

⁶ ADB. 2003. *Technical Assistance for Strengthening Results-Based Management for Sector Agencies*. ADB. 2004. *Technical Assistance for Decentralization in Social Sectors*.

⁷ Paragraph 67, *ADB's Anticorruption Policy (2 July 1998)*

⁸ 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 by Asian Development Bank and Its Borrowers (February 2007)*

- 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.⁹

10. 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.¹⁰

11. 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;¹¹
- 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 to mitigate opportunities for fraud, corruption or abuse in this project and future ADB-financed projects.

12. PPRA's are conducted in line with ADB's efforts to manage for development results. PPRA's 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.

13. To achieve the audit objectives, the Audit Team

- reviewed the Project's procurement and disbursement documents,
- evaluated the Project's procurement processes, internal controls and financial management practices,
- inspected the Project's goods and works at various project sites, and
- assessed the reasonableness of contract prices.

14. The Audit Team reviewed 100% of contracts awarded as of 31 December 2007, comprising 40 local/national competitive bidding (LCB/NCB) contracts totaling \$4.54 million, 2 international competitive bidding (ICB) contracts totaling \$0.35 million, 7 international shopping (IS) contracts totaling \$2.33 million, 12 direct purchase (DP) contracts of \$0.51 million, and 5 Procurement Contracts Summary Sheets (PCSS) pertaining to replenishments of imprest account and various PIU expenditures of \$1.64 million.

III. AUDIT FINDINGS AND RECOMMENDATIONS

15. The PPRA findings are categorized as follows: (a) project's procurement process; (b) asset inspection; (c) contract implementation; (d) financial management system, and (e) internal control weaknesses.

⁹ Paragraph 2, *Integrity Principles and Guidelines* (November 2006)

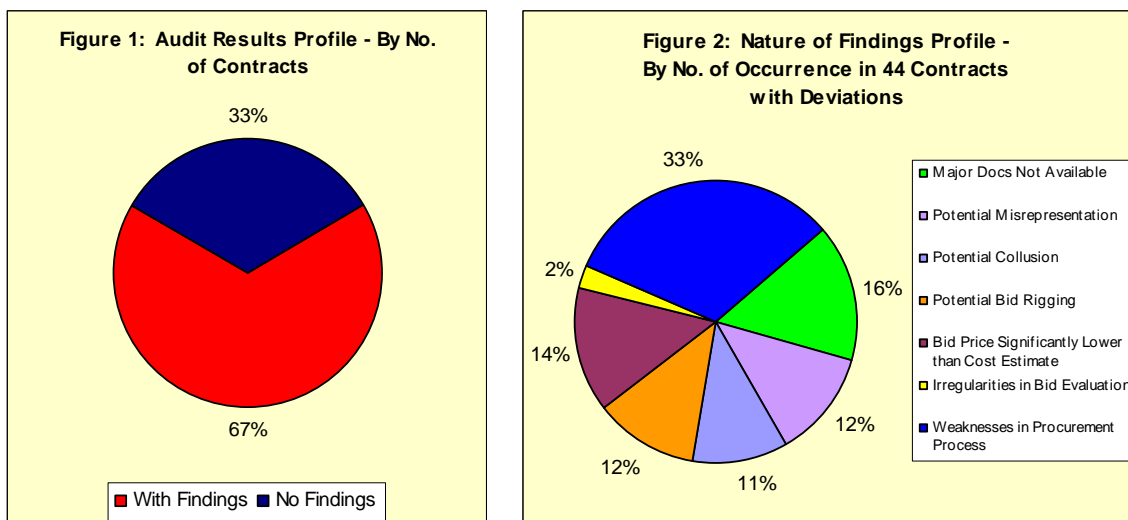
¹⁰ Paragraph 50, *Ibid*

¹¹ The Project's Loan Agreement between the Government of Mongolia and Asian Development Bank was dated 25 August 2003.

A. Project's Procurement Process

16. The following sections describe observations made during the PPRA which indicate that ADB's anticorruption policy may have been violated. To determine if this is so, the Office of the Auditor General, Integrity Division (OAGI) will investigate these irregularities subsequent to completion of the PPRA, in accordance with ADB's *Integrity Principles and Guidelines*. Violations to the policy invariably results in ineffective and/or improper use of aid funds, thereby reducing development effectiveness.

17. Out of the 66 contracts reviewed by the Audit Team, 44 contracts (or 67%) were compromised. Of these, there were 83 procurement-related findings noted by the Audit Team where one contract may have more than one type of deviation. Figure 1 presents the audit results profile in terms of percentages of contracts with and without findings relating to the procurement process. Figure 2 illustrates the breakdown of the 83 procurement-related findings found in 44 contracts.



1. Bid documentation Not Available

18. Required procurement-related documentation was not available for audit review.¹² These included key bid documents, namely bid proposals, minutes of bid evaluation committee/tender committee meetings, bid evaluation sheets, CVs of bidders for consulting services, and contracts. These pertain to 13 contracts (1 ICB, 7 LCB, 2 IS, and 3 DP), representing 15% of the 83 procurement-related audit observations.

19. This is a restriction to the scope of the audit. For contracts affected, the Audit Team was unable to evaluate if the bid process complied with ADB's *Procurement Guidelines*, other relevant guidelines, and conducted in line with ADB's anticorruption policy.

¹² The list of the audit requirements pertaining to procurement- and disbursement-related documents was provided to the PIU on 17 March 2008, prior to the PPRA planning mission on 1-8 April 2008. The fieldwork was undertaken during the period May up to mid-June 2008.

2. Potential Misrepresentation

Submission of potentially fraudulent financial statements

20. The ADB's anticorruption policy, along with the *Procurement Guidelines*, require all parties to ADB-financed activities (including borrowers, beneficiaries, bidders, suppliers, and contractors) to maintain the highest ethical standards for ADB-financed activities.¹³ Eighteen contractors who participated in the bids for 10 civil works contracts submitted financial statements with figures different from those submitted to the Taxation Authority.¹⁴ These comprise two winning bidders and the rest were losing bidders. Two of these bidders had been awarded two contracts and one was awarded five contracts. This finding represents 12% of the 83 procurement-related audit observations.

21. Most of these discrepancies had been noted during the evaluation process, which caused the disqualification of the bidders.¹⁵ The lack of thoroughness in the evaluation process, however, resulted to failure in picking up other inconsistencies noted during the audit. This caused the PIU to award contracts to bidders who fraudulently misrepresented their incomes.

3. Indication of possible Collusion

Competing bidders may be related parties

22. The Audit Team found similarities in addresses and telephone numbers amongst competing bidders across nine contracts. This represents 11% of the 83 procurement-related audit observations. Two of these were the only competing bidders in a contract for civil works renovation in Dashbalbar Soum, Dornod Aimag. These indicate possible collusion among participating bidders, diluting the benefits of a competitive bid process.

4. Indications of possible Bid Rigging

23. The Audit Team found 10 instances (or 12%) where possible bid rigging may have occurred.

Insufficient Time for Preparation of Bids

24. ADB's *Procurement Guidelines* provide that NCB is a procedure normally used for public procurement in the country of the borrower, and may be the most appropriate way of procuring goods or works which, by their nature and scope, are unlikely to attract foreign competition. Adequate response time for preparation and submission of bids shall be provided.¹⁶ The Public

¹³ 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 by Asian Development Bank and Its Borrowers (February 2007)*

¹⁴ As part of the PIU's due diligence, financial statements submitted by bidders were validated vis-à-vis Statement from Taxation Authority. The PIU, in their comments to the draft PPRA report indicated that the differences between the figures in the financial statements of 7 contractors and Statement from Taxation Authority were "mistaken references by Tax Officer."

¹⁵ Prior to this PPRA, OAGI had recommended to the Integrity Oversight Committee (IOC) the imposition of sanctions related to the misrepresentation of financial statements of certain of the bids. The IOC sanctioned 11 firms in connection with such misrepresentations.

¹⁶ Paragraph 3.4, *Procurement Guidelines (April 2006 and February 2007)*.

Procurement Law of Mongolia provides a deadline of 30 days or more for open bidding to provide bidders sufficient and equal time to prepare and submit their tenders.¹⁷

25. The Audit Team noted that bidders for re-bids of six NCB civil works contracts were only given 15 or 17 days to prepare and submit their bids. In addition, the deadlines for the sale of bid documents stipulated in the advertisements for five NCB contracts were on the same day as the bid opening date and the day before the bid opening date for one contract. This could have restricted fair competition which resulted in (i) receipt of only one to two bids for four of these six NCBs; and (ii) significant delays in the completion of three contracts, which had not been completed during the end of the audit fieldwork in June 2008. The PIU clarified that the submission deadline for bids was shortened due to the delay in official authorization of the documents sent to the Ministry of Finance (MOF) and the appropriate time for the civil works to start considering weather conditions.

Questionable Bid Price Discount and Duration of Work to be Performed

26. The Public Procurement Law of Mongolia provides that during bid opening, the procuring entity shall announce, among others, the bid price if alternatives have been permitted, alternative bid price, and price discounts offered. Any tendering price, price discount, and alternative tendering price not announced at the opening of tenders shall not be considered in tender evaluation. The procuring entity is prohibited from making negotiations with bidders on the content of the bid and price following the opening of tenders.¹⁸

27. The Audit Team noted that the bid opening report for one contract indicated that the bid price of one firm was discounted at 15%. This resulted to the firm's bid price as the lowest among the five bidders, which was 26% lower than the cost estimate. The Audit Team could not find any evidence to support the source of the bid discount. The contract due for completion on 1 October 2007 has not been completed as of end of audit fieldwork in June 2008.

28. The Audit Team also noted inconsistencies in the work duration in three winning bidders' proposals and in their respective contracts. The Audit Team could not find any written explanation for the changes in the work duration. In the absence of documentation to support the bid evaluation committee's decisions, the propriety of the procurement process is questionable.

Bid Prices not adjusted for Arithmetical Error Corrections

29. The ADB *Procurement Guidelines* and the Public Procurement Law of Mongolia provide for bid prices to be adjusted to correct any arithmetical errors.¹⁹ This is to determine the cost to the borrower of each bid in a manner that permits a comparison on the basis of their evaluated cost. There were two instances when bid prices were not appropriately adjusted for arithmetical corrections.

30. One resulted to a higher bid price of the winning bidder of a LCB contract, and the other pertains to the losing bidder of an IS contract. These indicate that the evaluation had not been appropriately done, which could tantamount to a waste of Project funds.

¹⁷ Article 24.3, *Public Procurement Law of Mongolia (effective 1 February 2006, with amendments on 6 February 2007)*.

¹⁸ Articles 26.3, 26.7 and 26.8. *Ibid.*

¹⁹ Paragraph 2.50, *Procurement Guidelines (April 2006 and February 2007)*.

5. Bid Prices significantly lower than Cost Estimates

31. Cost estimates for civil works are based on standard prices set by the Ministry of Construction and Urban Development. The Public Procurement Law of Mongolia provides “that the key criterion in evaluating responsive tenders shall be the tendering price”.²⁰ Also, “if tendering prices of all responsive tenders exceeded the procuring entity’s cost estimate by more than 5%” the procuring entity shall reject all tenders,²¹ and if “tendering prices of all responsive bidders exceeded the procuring entity’s cost estimate, the procuring entity shall make negotiations with a tenderer whose tendering price exceed by less than 5% in order to reduce the tendering price down to the cost estimate.”²²

32. The Audit Team observed that the bid prices of winning bidders were all lower than or equal to the cost estimates, and notably, those for 12 civil works contracts (or 14%) were significantly lower than the cost estimates ranging between 10% - 26%. Of these 12 contracts, three contracts had not been completed due to non-performance of the contractor resulting from inadequate experience and/or financial incapacity, and one had defects noted during the asset inspection resulting from use of sub-standard materials.

33. The foregoing observations on unsatisfactory contract implementation may also be attributed to the significant differences between the bid prices and cost estimates. Lowest-priced bids may only be cost-efficient if and when the contractor is technically qualified, and if technical specifications in the contract were fully met.

6. Irregularities in Bid Evaluation

Re-evaluation results significantly different from initial evaluation of proposals and extension of bid validity not communicated to all bidders

34. The Audit Team noted two instances (or 2%) where re-evaluation of proposals were undertaken after notification of the winning bidder and/or contract award. In both cases, the re-evaluation resulted to identification of a different winner.

35. For one LCB contract, the new winner was disqualified during the initial evaluation for having submitted a very low bid price, average sales lower than bid price, lack of evidence for financial capacity, and no similar civil works performed. On the other hand, the declared winner of the initial evaluation was disqualified during re-evaluation due to non-compliance with the average sales requirement.

36. For an IS contract, the new winner was disqualified during the initial evaluation for not submitting the required financial statements. On the other hand, the declared winner of the initial evaluation was disqualified during re-evaluation due to having submitted a bid price higher than the new winner.

37. The foregoing findings indicate lack of (i) consistency in applying the evaluation criteria among bidders by the evaluation committee, and (ii) thoroughness in determining compliance by bidders with bid requirements, e.g. audited financial statements submitted vis-à-vis Taxation

²⁰ Article 28.3, *Public Procurement Law of Mongolia (effective 1 February 2006, with amendments on 6 February 2007)*.

²¹ Article 30.1, *Ibid.*

²² Article 30.2, *Ibid.*

Authority statement; work performed vis-à-vis submitted certificates and contracts; key personnel required for the project vis-à-vis qualifications; and equipment vis-à-vis fixed assets if owned or authorized to lease. These shortfalls caused delays in contract award and implementation. For an IS contract signed in July 2007 for supply of diagnostic X-rays units, no deliveries had yet been made as of 31 December 2007, since delivery had been deferred on account of a complaint from the initially declared winner. As a result of the deferral of delivery, which should have taken place in September 2007, the supplier incurred interest and other charges with the manufacturer.²³

38. In the re-evaluation of an IS procurement, the extension of bid validity was communicated only to all four losing bidders in the initial evaluation, and was not communicated to the winning bidder. This not only contravenes the ADB's *Procurement Guidelines*²⁴ but is a deficiency in the procurement process.

7. Weaknesses in the Procurement Process

39. The Audit Team noted 27 instances (or 33%) of weaknesses in the procurement process.

Absence of criteria details and score allocation in selecting individual international consultants

40. The Audit Team was limited in validating the process for selection of individual international consultants in the absence of specific considerations and score allocations to the main evaluation criteria, namely, general qualification (20%), project-related experience (65%) and country experience (15%). The ratings included excellent (90-100%), good (80-89%), average (70-79%) and below average (0-69%), however, there was no clear-cut guidelines on what to consider (sub-criteria) under each evaluation criteria and allocation of scores for each sub-criteria. In effect, the evaluation tended to be subjective and lacked transparency.

Absence of score allocation for LCB selection criteria

41. The evaluation sheet provides for the criteria and sub-criteria to evaluate bidders in terms of

- responsiveness to bids (general criteria),
- eligibility,
- capacity of implementing the contract (financial capacity, technical capacity and work experience), and
- completeness of bid documents submitted.

The evaluation criteria and sub-criteria are rated on a (+) or (-) basis, which means complied or non-complied, respectively. There is no score allocation for each criteria/sub-criteria. The Audit Team could not ascertain the appropriateness of evaluation on capacity of contract implementation in the absence of score allocation. For instance, if all bidders met the sub-criteria requirements, the declaration of the winning bidder could be subjective on the part of the evaluation committee.

²³ The delivery was made in early 2008 and invoice from the supplier was submitted to the PIU on 29 April 2008.

²⁴ Paragraph 2.40, *Guidelines for Procurement Under Asian Development Bank Loans (November 2004)*, Paragraph 2.57, *Procurement Guidelines (April 2006 and February 2007)*.

Lack of due diligence in the evaluation process

42. A winning bidder submitted three debt-free certifications from banks/financial institutions, but its financial statements showed a liability of 0.749M MNT. The bidder on PIU's clarification explained the liabilities as advances for ongoing contracts. Without a third party verification by the PIU from the affiliate bank and/or reported clients for advances received, the reliability of information provided by the bidder cannot be established.

43. The evaluation of performed construction works for civil works contracts were generally not assessed based on submitted State Acceptance Notices and bidder's contracts with clients. Resulting figures indicated in the evaluation sheets were either based on amounts indicated in the bid proposal or list of construction works submitted by the bidder, and in a few instances could not be traced to these references or proof of performed works submitted. In two instances, the lists of performed works were even higher than the actual reported sales in the relevant periods evaluated.

44. The Audit Team was not able to validate assessments of bidders' compliance with bid requirements, e.g. licenses, third-party references, technical capacity, financial capacity, and completeness of bids due to lack of supporting documents. In addition, some evaluations were inconsistent with submitted documents or lacking in information to reflect the actual evaluation of bids. These deficiencies suggest questionable bid evaluation process, which may have caused re-evaluations, re-bids, and delays in contract implementation as a result of awarding to contractors with inadequate experience and/or financial capacity.²⁵

Contracts without Performance Securities, Performance Securities Submitted after Contract Signing, or Performance Securities Expired before Full Delivery of the Goods

45. ADB *Procurement Guidelines* provides for the bidding documents for works to require security in an amount sufficient to protect the borrower in case of breach of contract by the contractor. In contracts for supply of goods, suppliers or manufacturers may be required to provide a guarantee to protect against nonperformance of the contract.²⁶ The Public Procurement Law of Mongolia also provides for the procuring entity of goods, works or services to require the best evaluated bidder to furnish a performance guarantee at five percent of the contract value prior to entering a contract, and shall remain valid until contract evaluation and handover of goods, works or services.²⁷

46. The Audit Team noted two instances where contractors for works submitted performance securities after contract signing, three instances where evidence of submission of performance security was not seen, and one instance where a performance security of a supplier expired prior to delivery of goods, but was not extended.

47. In respect of a contract for the supply of medical equipment for five *aimags* and 14 *inter-soum* hospitals, the contract provides for the supplier to submit a performance security of 10% of the contract price, denominated in US\$ currency. The performance guarantee provided by the winning bidder, however, was for only 5% of the contract price.

²⁵ Relevant findings relating to re-evaluations, re-bids and delays in contract implementation had been discussed in different parts of this report.

²⁶ Paragraphs 2.39 and 2.40, *Procurement Guidelines* (April 2006 and February 2007).

²⁷ Articles 43.1-3, *Public Procurement Law of Mongolia* (effective 1 February 2006, with amendments on 6 February 2007).

No Insurance Policies submitted

48. ADB's *Procurement Guidelines*²⁸ and the EA's standard bid document for civil works stipulate the requirement for insurance in case (a) the work materials get lost and broken, (b) equipment and appliances are lost and broken, (c) any property related to the project is lost and broken; and (d) the workers get injured or killed, which should cover the period from the day the work starts until the quality warranty period ends. The Audit Team found that no insurance certificates were submitted.

Recommendations

49. For transparency and appropriateness of bid evaluation, and to ensure that only technically qualified bidders are awarded with contracts, it is recommended that MOH

- revisit the evaluation criteria and sub-criteria, and consider assigning individual scores for each sub-criteria;
- ensure that the PIU exercises due diligence in evaluation of bid proposals and quotations, and strictly observes applicable bidding procedures;

and that the East Asia Department (EARD), through the Mongolia Resident Mission (MNRM)

- identifies and augments appropriate training on procurement matters directed toward key procurement staff in order to improve capacity in this area.

50. To ensure protection against nonperformance of contract and losses of work materials, equipment, project-related property and workers, it is recommended that MOH

- strictly impose and implement the performance security requirement; and
- revisit the insurance requirement for contractors/suppliers/consultants.

51. It is requested that MOH, through the PIU, *Aimag* Coordinators, and *Aimag* Supervisory Groups

- assist and support OAGI in the future investigations on possible fraud and corruption matters identified through this PPRA.

B. Asset Inspection

52. The Loan Agreement requires that goods financed out of the proceeds of the Loan are used exclusively for the Project.²⁹ It also requires that the Project is carried out with due diligence and efficiency, and in conformity with sound administrative, financial, engineering, environmental, health, training, and educational practices.³⁰ To ensure compliance with these loan requirements, the Audit Team inspected 12 of the 40 civil works (30%) covering the five *aimags*, and five of the ten supply of goods contracts (50%).

²⁸ Paragraph 2.34, *Guidelines for Procurement Under Asian Development Bank Loans* (November 2004), Paragraph 2.26, *Procurement Guidelines* (April 2006 and February 2007).

²⁹ Section 3.04

³⁰ Section 4.01

Civil Works

53. Civil works were determined to be generally in line with contract specifications, structure consistent with the design, and utilized as intended. There were, however, defects which included

- paintings peeling off;
- leaking ceilings;
- heating facility smoke pipes broken or not in good condition;
- wall ceramic tiles used as floor tiles;
- misaligned windows and doors;
- toilets not working properly; and
- clogged water pipes

54. The contractor for a civil works contract did not meet warranty and maintenance obligations. Despite not having met its warranty and maintenance obligations in this contract, the same contractor was awarded another contract which has been substantially delayed by over a year and has not yet been completed at the time of the audit.

55. The repeated use of a contractor who has not met its warranty and maintenance obligations in prior contracts is not advisable if one is to ensure the Project is carried out efficiently.

Supply of equipment

56. The Audit Team determined that the equipment purchased out of the Project funds were generally in accordance with specifications. There were, however, some equipment that have not been utilized since delivery to the *aimags*, namely

- adult and pediatric respirators, due to absence of compressors, and
- biochemical analyzer, due to non-availability of reagents.

The PIU advised that compressors had already been purchased and are in the *aimags* for distribution to the *soums*, and training on how to operate the respirators for the *soum* health centers will be conducted. In addition, the MOH is taking steps to supply the reagents for the biochemical analyzers.

57. The Audit Team also determined that there had been lack of trained personnel to operate medical equipment in the *aimags* and *soums*. In addition, most major medical equipment has foreign manufacturers, and the instructions on how to operate the purchased equipment are in foreign language not understood by relevant personnel.

Recommendations

58. To ensure that contracts are implemented efficiently and maintained properly after completion, it is recommended that MOH and PIU

- implement periodic inspection of the Project, and effect immediate repairs, as necessary; and

- exercise prudence in awarding subsequent contracts to contractors who did not perform satisfactorily in an earlier contract.

59. To enable effective delivery of project objectives and to enhance capacity at the provincial levels, it is recommended that MOH and PIU

- ensure that contracts with suppliers of equipment with foreign manufacturers should provide translated brochures and instructions on how to use the equipment, and include training as such.

C. Contract Implementation

Civil works implementation delays

60. Review of available documentation disclosed that of the 40 civil works contracts which should have already been completed by 31 December 2007, seven have not been completed. These were due to non-performance by the contractor as a result of inadequate experience and financial capacity, changes in the design/location as a result of geological analysis, breakage in central heating system, and transportation problems due to the remoteness of location.

61. Substantial delays had also been encountered, ranging from 2 months to over 1 year. The delays had been attributed to changes in plans, shortage of electricity, additional works, transportation problems, change of project location as a result of geological analysis, low capability of workers, simultaneous projects of the contractor, and changes in material to be used to suit the Project location. Penalties had been imposed by the PIU and paid for by the contractors for delays in contract implementation.

62. It is worth noting that four contracts had been completed in accordance with contract terms. The control and supervision of the civil works contracts implementation plays an important role to ensure early detection and resolution of the problems on the field.

Delays in delivery of medical equipment

63. A contract signed with a winning bidder, after a re-evaluation process, for the supply of medical equipment was signed in July 2007, for delivery of equipment in September 2007. No deliveries had been made as of 31 December 2007 due to suspension/deferral by the PIU of delivery, pending resolution of a complaint filed by the initial winning bidder. The winning bidder had entered into a purchase agreement with another firm for the medical equipment. As a result of the deferral of the shipment of the equipment, interests and other charges had been accumulated by the winning bidder. Delivery of the equipment was made in the first quarter of 2008.

Recommendation

64. The major flaws noted in contract implementation had notably been caused by deficiencies in the evaluation process earlier discussed. Delays in contract implementation impede project completion and its development objectives, and may result to dissipation of beneficiaries' opportunities to use these to their advantage. It is recommended that for future contracts, MOH and PIU

- institute stringent control and supervision of civil works contracts; and

- review supervision reports and follow up corrective actions, if any

and that EARD (through MNRM)

- establish circumstances leading to these deviations, and institute checks and balances as necessary.

D. Financial Management System

65. The Audit Team examined the financial management system at the PIU, including their financial accounting, management accounting, financial reporting, internal controls, and disbursement process. The Audit Team concluded that the PIU maintained good financial records on ADB accounts and project funds were generally disbursed properly and used for their intended purposes.

66. It was observed that different exchange rates were used by the PIU and ADB for the same transactions relating to direct payments in 2005 and 2006, and no reconciliations had been made for these types of transactions. The issue was resolved in 2007 when ADB started paying in Tugriks.

67. The contract provides for the terms of payment to contractors, suppliers and consultants. The Audit Team also observed that there had been payments made to contractors, suppliers, and consultants that were significantly delayed. Delays in payments had been a cause of implementation delays for a number of contracts.

Recommendation

68. Delayed payment to contractors/suppliers had delayed contract implementation, eroding the timely benefits of the project to its beneficiaries. It is recommended that MOH, in coordination with EARD

- assess the causes of delays in payment to contractors, suppliers and consultants and institute appropriate measures to ensure prompt payments.

E. Internal Control Weaknesses

69. The Audit Team also assessed the Project's internal controls and identified the following areas for improvement. Strong internal controls significantly reduce the risk of undetected fraud and corruption, and are vital in ensuring Project funds are directed towards stated objectives, for its intended beneficiaries.³¹

Inconsistencies in Recording of Bid Opening Time and Dating of Bid Evaluation Report and Contract

70. The Audit Team observed certain inconsistencies in the recording of bid opening time in the bid opening record (Mongolian and English versions) and Minutes of Bid Opening for seven LCB contracts. Furthermore, there had been instances of inconsistencies in the dates of the evaluation reports and contracts. These inconsistencies give way to questionable procurement processes and timing thereof.

³¹ Note that this section does not include controls already referred to previously in this report.

Unsigned bid documents

71. Some bid documents, which include bid opening report, bid evaluation reports, and minutes of bid evaluation committee meeting for three contracts were not signed by all or majority of the members of the bid evaluation committee. Consequently, it was difficult to determine if the bidding process was done in an appropriate and transparent manner.

Unsatisfactory recordkeeping and record management

72. The Loan Agreement³² specifies that the Borrower shall enable ADB's representatives to inspect relevant Project records and documents. The Audit Team noted that the Project's documentation has not been kept systematically at the PIU, resulting in difficulty and delays in locating certain key documents. Consequently, it was difficult to effectively resolve audit questions relating to the effectiveness and integrity of the Project activity. Some major documents had only been made available to the Audit Team after the exit conference.

Recommendations

73. To ensure accuracy of audit trail of the procurement processes for ADB-financed projects, the importance of appropriateness of review is being stressed. MOH must strengthen internal controls at all levels of Project management. The following are recommended:

- strongly encourage improvement in records management at all levels of project implementation in order to enhance accountability;
- develop and implement an effective database which includes key contract data and tracks significant project activity by *aimag*, *soum*, and by contract, to assist with high level monitoring of contract implementation; and
- appropriately review documentation of procurement deliberations and decisions to ensure accuracy of information.

IV. CONCLUDING COMMENTS

74. The Audit Team acknowledges the challenges inherent in the decentralization of Project implementation to effectively deliver health services to the poor and vulnerable in Mongolia's targeted areas. Greater collaboration may be required between EARD (and MNRM) and MOH/Government of Mongolia to establish an effective monitoring mechanism for future decentralized projects in Mongolia, and to ensure transparent procurement and financial management capacity at all levels. Lessons learned from this project procurement-related audit should be adapted in the implementation of the Third Health Sector Development Project in Mongolia.

75. The significant deviations at the PIU from applicable guidelines in relation to procurement, and lack of thoroughness in the evaluation process are of concern. It is important that internal control weaknesses and non-compliance instances identified here do not recur in future and similar projects in Mongolia. 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.

³² Article IV, Section 4.08