ASIAN DEVELOPMENT BANK

PROJECT PROCUREMENT-RELATED REVIEW REPORT
Loan 2087-MON(SF): Regional Road Development Project, and Loan 2621-MON(SF) and Grant 0199-MON(SF): Regional Road Development Project – Supplementary

Office of Anticorruption and Integrity

October 2013

A Project Procurement-Related Review (PPRR) is

a review undertaken by OAI on ongoing ADB-financed projects, to confirm compliance with applicable ADB policies, guidelines, and the loan agreement, with a focus on preventing and detecting integrity violations (http://www.adb.org/Integrity/integrity-violations.asp) involving ADB-related activities or ADB staff as defined under ADB's *Anticorruption Policy,* as amended (http://www.adb.org/sites/default/files/pub/1998/ anticorruption.pdf), and ADB's *Integrity Principles and Guidelines* (http://www.adb.org/sites/default/files/integrity-principles-guidelines.pdf).

ADB's *Anticorruption Policy* requires all parties, including staff, borrowers, beneficiaries, bidders, consultants, suppliers, and contractors to observe the highest ethical standards when participating in ADB-related activities. The Policy supports ADB's obligation, in accordance with Article 14(xi) of the Agreement Establishing the Asian Development Bank, to ensure that the proceeds of ADB financing are used only for intended purposes.

The PPRR assesses internal controls in place, identifies irregularities and instances of noncompliance, inspects the project outputs, and recommends enhancements to mitigate or eliminate opportunities for fraud, corruption, or abuse of resources and to help improve development effectiveness of future projects.

A Project Procurement-Related Review is not

an evaluation to assess development effectiveness of ADB-funded projects. It does not review project outcomes or development impact, which can only be assessed after the finalization of a project.

CURRENCY EQUIVALENTS
(as of 31 May 2012)

Currency Unit	=	Tugrik
MNT 1.00	=	$0.0007599
$1.00	=	MNT 1,316

ABBREVIATIONS

ADB	-	Asian Development Bank
CTL	-	ADB Controller's Department
EA	-	executing agency
EARD	-	ADB East Asia Department
EATC	-	ADB East Asia Transport and Communications Division
ICB	-	international competitive bidding
IPC	-	interim payment certificate
JV	-	joint venture
LGFIS	-	Loan and Grant Financial Information Services
MRT	-	Ministry of Road and Transportation
OAI	-	ADB Office of Anticorruption and Integrity
OSFMD	-	ADB Operations Services and Financial Management Department
PMO	-	project management office
PPRR	-	project procurement-related review

NOTE

In this report, $ refers to US dollars.

CONTENTS

EXECUTIVE SUMMARY

1. The Office of Anticorruption and Integrity (OAI), Asian Development Bank (ADB)[1] conducted a project procurement-related review (PPRR) of Mongolia's Regional Road Development Project (the Project) comprising Loan 2087-MON(SF), supplementary Loan 2621-MON(SF), and Grant 0199-MON(SF)[2] from July to September 2012. This report documents findings and makes recommendations as a result of the PPRR.

Background

2. Mongolia is becoming increasingly urbanized. Given its landlocked position between the People's Republic of China (PRC) and the Russian Federation, connectivity is vital for Mongolia's development. However, poor infrastructure and undeveloped trade systems lead to costly transport, complex logistics, and long transit times. Trading across borders is difficult and expensive. As a result, costs of essential imports – including food – are driven higher, and competitiveness of Mongolian exports is eroded. In recent years, ADB's strategy has been to, among others, enhance Mongolia's transport links with neighboring countries and promote regional cooperation and integration, as well as improve road safety.[3]

3. Mongolia has experienced exceptionally high inflation over much of the period examined in the PPRR. The annual increase in Mongolia's consumer price index was 9.6% in 2005, 5.9% in 2006, 14.1% in 2007, and 23.1% in 2008. The prices of the road construction materials soared. For example, between 2006 and 2008, the price of bitumen increased by 117%, the price of diesel rose by 154%, and the price of petrol rose by 193%. The inflationary conditions have presented a major challenge for implementation of civil works contracts, and have contributed to delays and failures in road construction contracts.[4] **Appendix 1** provides the Project background.

4. The Ministry of Road and Transportation (MRT) is the executing agency (EA) following the 2012 national elections. The Project was previously implemented by the Ministry of Road, Transport, Construction and Urban Development as stipulated in the Financing Agreement dated 14 April 2010, and by the Department of Roads under the Loan Agreement dated 26 January 2005 for Loan 2087-MON(SF).

5. *Severe cost overrun.* When Loan 2087-MON (SF) was approved in 2004, the Project cost approximately $78.1 million, with ADB financing 48% of the total Project cost through its Special Funds. In 2010, when ADB approved supplementary Loan 2621-MON (SF) and Grant 0199-MON (SF) aggregating $23.8 million to finance the cost overrun, the Project was estimated to cost approximately $141.9 million, an increase of $63.8 million or 82%.[5] The cost overrun was attributable to cost underestimation and implementation delays, combined with high inflation.[6]

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1 OAI staff members and OAI-engaged consultants comprised the PPRR team.

2 The loan agreement was signed on 26 January 2005, and the financing agreement for supplementary loan and grant was signed on 14 April 2010. The loan became effective on 1 July 2005, with revised closing on 30 July 2014. The original loan closing date was 1 January 2010.

3 ADB. *Development Effectiveness Brief: Mongolia (A Partnership against Poverty)*. Manila.

4 ADB. 2010. *Report and Recommendation of the President to the Board of Directors on a Proposed Supplementary Loan and Grant – Mongolia: Regional Road Development Project.* Manila.

5 In 2007, in order to offset a shortfall in financing as bid prices for civil works were much higher than originally estimated, ADB increased the loan amount by transferring the project surplus loan proceeds of $4.5 million equivalent from the completed Second Roads Development Project.

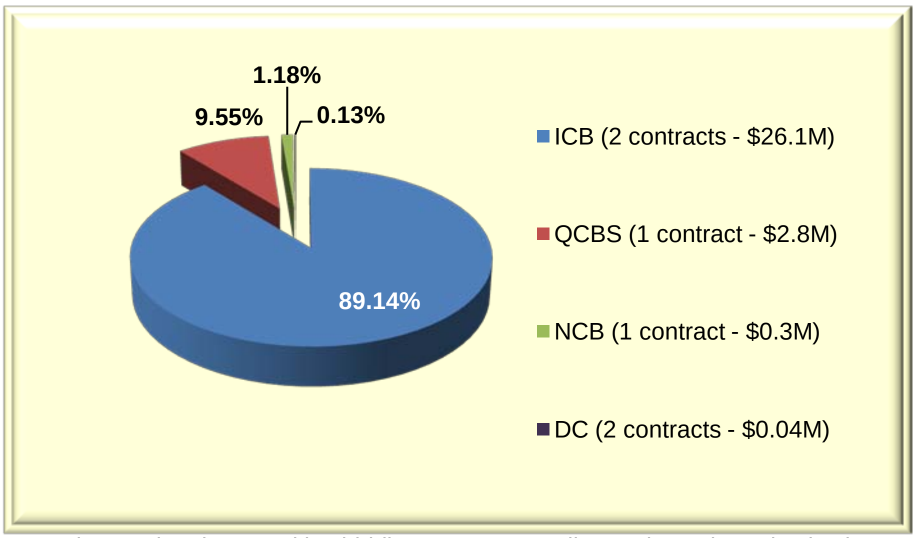
6 Refer to footnote 4.

6. Of the total estimated $141.9 million Project cost, ADB is financing $67.5 million (or 48%), and the other portions are financed by the Millennium Challenge Corporation ($47.2 million or 33%), the Governments of Mongolia ($18.8 million or 13%), Republic of Korea ($4.6 million or 3%), and the People's Republic of China ($3.2 million or 2%).

PPRR Scope

7. The PPRR team selected eight contracts aggregating $29.3 million (or 96% of total contracts awarded) from the works, consulting services, and training categories.[7] The PPRR team reviewed the procurement processes and related documentation, disbursements and financial management system, and Project outputs. **Appendix 2** provides the PPRR objectives, scope and methodology.

Figure 1: PPRR Scope by Procurement Mode in Terms of Value



ICB = international competitive bidding, QCBS = quality- and cost-based selection, NCB = national competitive bidding, DC = direct contracting

Key Findings

8. *Implementation delays.* This Project has encountered significant implementation delays caused by a number of factors (e.g., civil works cost overrun due to cost underestimation and high inflation; delayed issuance of work permits and customs clearances; changes in engineering designs; poor performance of civil works contractors for three civil works packages leading to termination of the contracts; re-biddings; and court cases). As of 31 May 2012 the Project had awarded five civil works contracts. Two of the contracts are almost completed, which are being undertaken by Contractor A. The three other contracts were terminated in 2011, two of which were awarded to Contractor B[8]. Contractor B requested price adjustments, and the Government negotiated a one-time price adjustment from ADB's supplementary financing. However, Contractor B withdrew its workforce, hence the contracts were terminated. For the third terminated civil works contract, the contractor failed to mobilize resources.[9] These

[7] The PPRR review cut-off date was 31 May 2012. Of the eight contracts selected, two were terminated.
[8] Contract packages NP1 and AR2.
[9] Contract package NP2 awarded to Contractor C.

packages were subsequently rebid, and were either at the bid evaluation or contract award stage during the PPRR.

9. *Lack of procurement-related documents.* The majority (57%) of the procurement-related documents for the selected PPRR samples were not provided. No documents were provided for two contracts[10] and as such, meaningful analysis and conclusion on the procurement processes of these contracts could not be drawn.[11] The lack of documentation posed a significant concern on the integrity and competitiveness of the bidding processes. Not making available the procurement-related documents to the PPRR team is a breach of the Loan Covenant, which ADB's East Asia Transport and Communications Division (EATC) agreed (paras. 31-32).[12] EATC indicated that as per their records, procurement of the two contracts with deficient documentation was generally compliant with ADB's procedures, and both were satisfactorily implemented.[13] EATC assured OAI to raise the breach of the Loan Covenant with the Government and seek its commitment to avoid similar breaches in future.

10. *Major procurement irregularities.* Review of the procurement process identified approximately 91% ($27 million) of selected contracts, including those without procurement-related documentation, vulnerable to Project loss.[14]

11. The standard bid document issued to the bidders provides that to evaluate the financial capacity of bidders, they should show that their financial resources, net of current work commitments are available to meet the total construction cash flow demands of the contract of $2 million. The evaluation committee failed to consider the bidders' current work commitment and current liabilities that should be paid out of the liquid assets when calculating the required cash flow. Had the current obligations been considered, the winning bidder would not have met the overall cash flow requirement. As the bidder failed to mobilize, the contract was subsequently terminated and rebid. Implementation of the works for this contract was delayed by two years (para. 36).

12. Other key issues include:

- misrepresentation of procurement exercise and evaluation report to ADB which formed the basis for ADB's no objection (paras. 42-44); and

- construction supervision consultants allowed to work without a valid contract (para. 48).[15]

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[10] PCSS 0010 Installation of Road Safety Features and PCSS 0011 Construction of Access Road to Ederne Soum (Contract Package AR1).

[11] The list of PPRR requirements pertaining to procurement and disbursement-related documents was provided twice to the EA: (i) on 10 July 2012, prior to the PPRR planning mission from 25 July to 8 August 2012; and (ii) on 22 August 2012, prior to the PPRR fieldwork from 3 to 28 September 2012.

[12] Section 4.04 of the Loan Agreement [Loan 2087-MON)] provides for the Borrower to enable ADB's representatives to inspect the Project, the goods financed out of the proceeds of the Loan, and any relevant records and documents.

[13] The PPRR team validated satisfactorily the implementation of contract package AR1 through its asset verification. However, the contract package for installation of road safety features was not part of the PPRR scope for asset verification.

[14] The potential amount of Project loss only includes the values of contracts affected. The full financial impact of procurement irregularities and lapses may be difficult to identify and quantify since this also includes costs of contract cancellations, rebidding, implementation delays, forgone trade revenue from use of the project and access roads, increased review and monitoring, and other variables.

13. *Financial management weaknesses.* The PPRR identified that the Project financial management system, including the Project Management Office's (PMO) payment process, provides opportunities for misappropriation of Project funds. The Excel-based accounting system lacked information security and back-up controls, which compromised the integrity of Project accounting records (paras. 57-58). Project accounts for the original loan and supplementary financing were not separately maintained, which is a breach of the Loan Agreement and Financing Agreement (para. 53).[16] Furthermore, separate ledgers were not maintained for contracts with the same contractor, and these ledgers were not updated which hindered determination of contract balances (paras. 54-55). These serious gaps in the design of the Project financial management system led to irregularities in processing and recording of disbursements as highlighted below:

- payments made for potentially ineligible expenditures[17] (paras. 64-65);
- irregular disbursement of salaries and misclassification of salary expense under various expense accounts (paras. 59-61); and
- inappropriate and inadequate documentation of PMO staff advances (para. 62).

14. *Project accountant's conflicting roles.* The Project Accountant[18] performed incompatible functions (i.e., handling blank checks; approving checks and direct payments as second signatory; recording transactions; maintaining Project accounts; and reconciling Project accounts with bank and ADB records), thus preventing proper checks and balances. There is also a risk of single point dependency on the Project Accountant (para. 73).

15. *Questionable quality of audit reports.* The PPRR team is concerned that contrary to the PPRR results, the annual audited project accounts and use of statement of expenditures (SOE) procedures provided unqualified opinion but failed to report the internal control weaknesses. The quality of audit therefore is deemed questionable (para. 72).

16. *Implication.* Consequently, the Project funds may not have been appropriately used for development objectives, or that the procurement and disbursement processes may not have been free from fraud and corruption.

Key Recommendations

17. *Missing documents.* The PPRR team recommends that the EATC provides a strong warning to the EA about the serious repercussions for breaches of the Loan Agreement. As such, the EA should ensure all Project-related documents are kept safe throughout the life of the Project and made available to concerned stakeholders (para. 80).

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[15] The construction supervision consultant's contract had expired for one year before it was extended. Services rendered by the consultants during the period without the amended contract amounted to about $260,000 while payment made to them amounted to about $135,000.

[16] Loan Agreement, Section 4.02 and Financing Agreement, Section 4.01(b).

[17] Ineligible expenditures in this report pertain to payment of: (i) expenses not specified in the contract; (ii) expenses without adequate supporting documentation; and (iii) non-Project-related expenses.

[18] The Project has the same Project Accountant since its inception. While a bookkeeper was appointed in April 2012, the role was limited to handling petty cash and inventory for the Project.

18. *Flawed evaluation.* The PPRR team recommends that the EA enhance its supervision of the procurement exercise and ensure that the evaluation committee is equipped with necessary technical skills to appropriately evaluate bid submissions (para. 82.a).[19] In addition, EATC should ensure that the EA and its evaluation committee understand how to assess the bidders' financial resources (para. 84.a).

19. *Misrepresentation of procurement exercise.* The procurement process for the recruitment of two individual consultants for the road safety audit was highly irregular and the evaluation report contained misrepresentations. This contract should not be funded by ADB. Hence, EATC in coordination with ADB Controller's Department (CTL) should seek refund of $15,000 paid from the loan funds (para. 81).

20. *Consulting services with no valid contract*. Without a valid contract, there was no basis for authorizing and processing of payment to the construction supervision consultants. It is recommended that the PMO ensure extensions of contracts are appropriately executed prior to allowing continuation of consulting services (para. 83).

21. *Inadequate capacity of the Project accounting team*. Lack of basic controls over financial management and disbursements may have exposed the Project to situations where funds were not optimally used for intended purposes. Considering that the Project implementation has gained momentum, the PPRR team recommends that the EA, in coordination with EATC, revisit the capacity (i.e., staffing and qualifications) of the Project accounting team to ensure that transactions are accurate, appropriately supported, promptly recorded, and reconciled. In addition, all transactions should be reviewed and approved by the PMO Coordinator (para. 89).

22. *Lack of information security controls.* The PPRR team recommends that the EA strengthen the information security and back-up/recovery controls to safeguard from unauthorized modification and loss of data. It is also recommended that the EA consider automating the accounting system that would include built-in controls and facilitate efficient processing of transactions (para. 85.d).

23. *Non-maintenance of separate Project accounts*. It is recommended that separate Project accounts be maintained for the Loan and the supplementary Loan and Grant as required by the Loan and Financing Agreements. Furthermore, individual ledgers should be maintained for each contract to readily determine contract utilization and payment milestones (para. 85.a-c).

24. *Potentially ineligible expenditures*. The PPRR team recommends that EATC, in coordination with CTL, take necessary steps to confirm ineligible expenditures noted, and seek refund, where warranted (para. 86).

25. *Questionable quality of audit reports.* It is recommended that EATC, in consultation with the EA and ADB Operations Services and Financial Management Department (OSFMD), assess the quality of the audit reports and revisit the terms of reference of the external auditors to include a management reporting requirement that should contain audit findings, recommendations and management responses (para. 88).

[19] In their response to the draft report, EATC shared that they have taken steps to address the evaluation committee's capacity, including providing international consultant support. This helped expedite the rebidding of NP2 and the procurement for tranche 1 of another ADB-financed transport sector project. In addition, EATC advised of the new Government's recent procurement reform which transferred procurement responsibilities to a centralized procurement agency in place of EA's evaluation committees.

Concluding Remarks

26. The PPRR indicates serious findings that if not promptly resolved would adversely affect the continuity of Project implementation. The PPRR team recognizes the actions taken by EATC over the past 2-3 years to enhance Project oversight, resulting in the Project now progressing steadily toward physical completion.[20] The PPRR team encourages the ADB East Asia Department (EARD) to continue to work together with the Government to strengthen its commitment in promoting transparency and accountability in this Project and future ADB-financed projects in Mongolia. The key recommendation is that assistance must be provided to the EA and the PMO in the areas of records management, procurement and disbursements.

27. Strong procurement and financial management controls and compliance to relevant guidelines mitigate the risk of improper use of Project funds and assets, maximize development effectiveness[21] and deter fraud and corruption. MRT should take the lead in strengthening procurement and financial management controls in the transport sector, and collaborate with ADB to strengthen Mongolia's capacity to manage for development results.

28. The PPRR team acknowledges the weaknesses in the Project supervision of EARD during the earlier years of implementation. The PPRR team also appreciates EARD's collaboration with MRT to move the Project implementation forward since late 2011. Given that serious irregularities were identified, it is imperative that lessons learned from this PPRR are carried forward throughout the remaining life of the Project as well as to other ADB-financed infrastructure projects in Mongolia. ADB's EARD should ensure that inherent risks are properly managed and project management is optimized. OAI will liaise with EATC on the follow-up of the implementation of the PPRR recommendations.

29. The PPRR team thanks the officers of the Ministry of Finance (MOF), MRT, and the PMO, including the construction supervision consultants, for their cooperation and assistance during the PPRR. The cooperation of EARD in this exercise is also appreciated. OAI acknowledges the significant contribution of ADB's Mongolia Resident Mission (MNRM) to the efficiency and conduct of this PPRR. ADB values the courtesy and support extended to the PPRR team.

[20] In their response to the draft report EATC pointed out that they have taken steps to augment project oversight as follows: (i) strengthening the EATC team supervising the project; (ii) fielding more frequent and larger review missions; (iii) out-posting an International Staff to ADB MNRM to strengthen day-to-day oversight of the transport portfolio; and (iv) providing staff consulting services to support procurement and related tasks. This has been complemented by support provided to the EA by an ongoing technical assistance.

[21] Note that comments on development effectiveness throughout this report are limited to and based on PPRR 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.

DETAILED FINDINGS

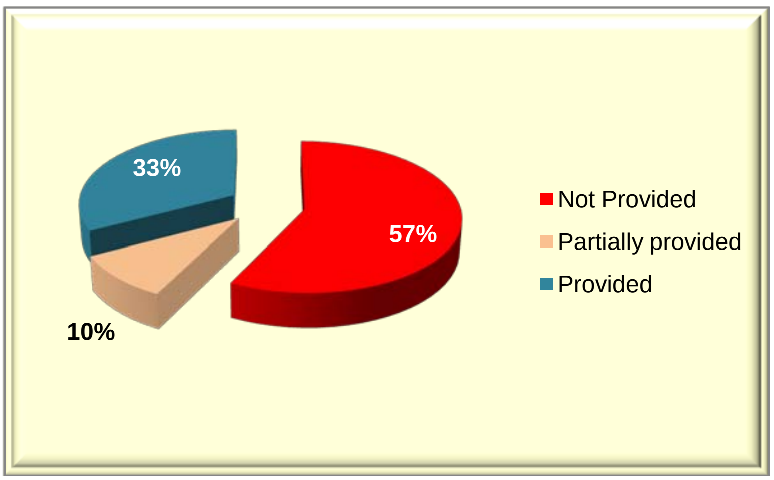
30. The PPRR findings are organized in the areas of procurement, financial management, internal controls and asset verification as highlighted below.

A. Procurement

Procurement-related documentation not available

31. Documentation management and retention, a basic internal control, which has a pervasive impact on project implementation is lacking. This is a serious concern. Not all required procurement-related documentation was made available for the PPRR.[22] These included key documents such as bid proposals, minutes of pre-bid meetings, bid opening records, bid evaluation sheets, minutes of negotiations, and signed contracts representing 57% of the required procurement-related documentation. Documentation pertaining to two contracts[23] (25% of samples) aggregating $2.6 million was not made available to the PPRR team. The lack of complete procurement-related documentation is a restriction to the scope of the PPRR. For contracts affected, the PPRR team was not able to evaluate whether the bid processes complied with ADB's *Procurement Guidelines*, *Consulting Services Guidelines*, and other relevant guidelines (e.g., ADB's *Anticorruption Policy*).

Figure 2: Procurement-Related Documents across all Samples



32. The PPRR team was informed by MRT that some of the documents may have been lost when transferred from one EA to another when changes in EAs occurred.[24] The PPRR team appreciates the archived documents provided for review, and was also advised about the Government's records management and retention procedures.[25] Twenty percent of the

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[22] Refer to footnote 11.

[23] PCSS 0010 Installation of Road Safety Features and PCSS 0011 Construction of Access Road to Ederne Soum (Contract Package AR1).

[24] As a result of the 2012 national elections, MRT became the new EA. In the Financing Agreement dated 14 April 2010, the Ministry of Road, Transportation, Construction and Urban Development was stipulated to assume the role of the EA which was previously handled by the Department of Roads under the Loan Agreement dated 26 January 2005 for Loan 2087-MON(SF).

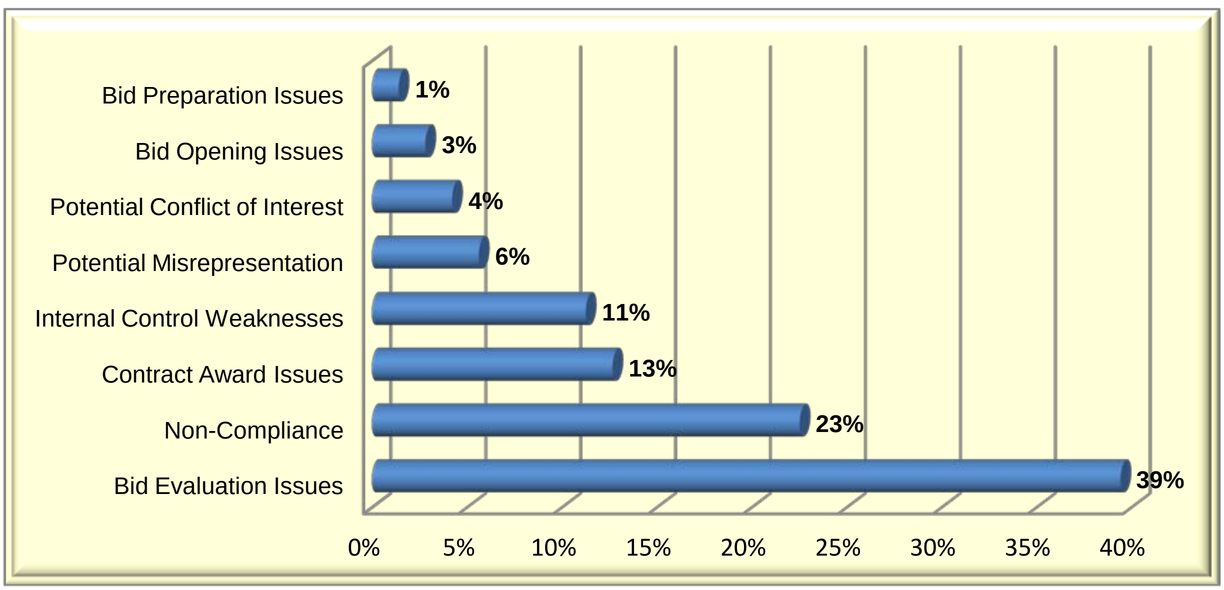
[25] Documents relating to losing bidders are retained for one year while those for winning bidders are retained throughout the life of the Project.

documents not provided to the PPRR team pertained to those of the winning bidders. This is non-compliant with the Government's records management and retention procedures, which require documents of winning bidders to be retained throughout the life of the Project. The PPRR team notes that the Government's retention policy conflicts with the Loan Agreement which provides that ADB representatives can inspect any Project-related records and documents, among others – meaning, all Project-related documents should be retained throughout the life of the Project.

Overall procurement-related findings

33. Out of the eight contracts selected for PPRR, only six were reviewed as the procurement-related documentation for two contracts was not made available to the PPRR team. There were 71 procurement-related findings noted in the six contracts reviewed as illustrated in **Figure 3**. The PPRR findings were discussed and signed off by the key project officials, and their clarifications were taken into account.

Figure 3: Nature of Findings



Potential integrity violations

34. Based on the review of the Project's procurement procedures and documentation of the six selected contracts, the PPRR team noted instances where ADB's *Anticorruption Policy* may have been violated. To determine if this is so, and in accordance with ADB's *Integrity Principles and Guidelines*, OAI will investigate the indicators in relation to possible conflict of interest leading to possible collusion by consultants in two contracts aggregating $2.8 million, and misrepresentation by bidders in their bid and performance security submissions in two terminated civil works packages. Violations of ADB's *Anticorruption Policy* invariably result in ineffective and/or improper use of the Project funds, thereby reducing development effectiveness.

Civil works

Improper bid evaluations

35. The assessment of the bidder's financial capacity, personnel and equipment was not appropriately conducted as supporting documents were not properly validated and analyzed during bid evaluation. Of the overall procurement findings, 34% pertained to improper bid evaluations of civil works contracts.

Flawed evaluation of cash flow – contract package NP2 (terminated for poor performance)

36. The PPRR team noted that the criteria on evaluating financial resources of bidders did not include current obligations (i.e., current liabilities) that should be paid out of the liquid assets.[26] Hence, the evaluation committee failed to consider the bidders' current obligations in the calculation of cash flow. The evaluation committee also did not properly apply the criteria when it excluded the bidders' current works commitments in its calculation. If these were considered, the winning bidder's overall cash flow would not have met the requirement **(Table 1).** This may have contributed to the winning bidder's failure to mobilize resources leading to contract termination.

Table 1: PPRR Team's Calculation of the Bidders' Financial Capacity

Description	Bidder no. 1	Bidder no. 2	Bidder no. 4	Bidder no. 6	Bidder no. 7 (winning bidder)
Liquid assets /a	132,209,727	51,035,761	3,817,703	524,163,262	5,400,821
Less: Current liabilities	127,601,438	36,547,788	2,284,830	360,102,773	3,590,668
Liquid assets net of current liabilities	4,608,289	14,487,973	1,532,873	164,060,489	1,810,153
Add: Other financial sources	111,395,175	9,071,944	/d	5,000,000	/e
Financial resources /b	116,003,464	23,559,917	1,532,873	169,060,489	1,810,153
Less: Current works committments	81,503,728	25,574,385	63,762,830	86,994,645	0
Available financial resources /c	34,499,736	(2,014,468)	(62,229,957)	82,065,844	1,810,153

/a Liquid assets as defined in ADB's User's Guide Procurement of Works Standard Bidding Documents (August 2012): Cash and cash equivalents, short-term financial instruments, short term available-for-sale-securities, marketable securities, trade receivables, short-term financing receivables and other assets that can be converted into cash within one year.

/b Where financial resources comprise working capital (liquid assets less current liabilities) plus unencumbered real assets, lines of credit, and other financial means.

/c The available financial resources of bidders 2, 4, and 7 were insufficient to meet the minimum cash flow requirement of $2 million. Bidder no.7 was awarded the contract.

/d The bidder's other financial resources comprised the remaining balance of $32,520 of the corporate loan, which is already part of the current assets.

/e The bidder's declared financial resources of $2.04 million is already part of the liquid assets.

[26] Section 3(2.3.3) Evaluation and Qualification Criteria – Financial Resources of the Bidding Document for Section NP2 provided for the bidders to show that their financial resources, in terms of their liquid assets, unencumbered real assets, lines of credit, and other financial means, net of current works commitments are available to meet the total construction cash flow demands of the contract of $2 million.

Lack of due diligence on bid submissions

37. The PPRR team noted that the bid evaluation committee did not seek clarification from the bidders concerned in regard to arithmetical errors, inconsistencies, and incomplete information in the bid submissions. It was further noted that the bid evaluation committee based its assessments on the bid forms at face value without validating these against the supporting documents submitted. These resulted in questionable evaluations, which led to the unsuccessful implementation of contracts.

Inconsistent evaluation of bidders' submissions

38. The review of documentation supporting bid forms established instances where bidders who did not meet some of the requirements in the evaluation criteria (e.g., key personnel, mobilization schedule, joint venture agreement, power of attorney, equipment, experience, etc.) were assessed "complied" or "acceptable" and vice versa without appropriate explanation or justification in the bid evaluation report. Inconsistent application of bid criteria during evaluations may lead to questionable, one-sided or subjective bid evaluation results.

Bid evaluation reports lack appropriate information

39. The bid evaluation reports lacked sufficient information and appropriate justification to explain the results of the bid evaluation (i.e., financial capacity situation and pending litigation for ICB contract package B1) or the examination for completeness of bids (i.e., bidders' mobilization and temporary construction facilities for the terminated ICB contract package NP2). Furthermore, the bid evaluation report for the terminated ICB package NP1 did not include the justification for acceptance by the evaluation committee of a bid with insufficient bid security, contrary to ADB's advice. Bid evaluation reports with inadequate and unclear information appear to conceal erroneous or subjective assessments favoring certain bidders.

Other noncompliance issues and procurement weaknesses

40. The bid security of a losing bidder[27] for contract package NP2 named the secretary of the bid evaluation committee as the beneficiary, instead of the EA as the employer. This was, however, accepted as a valid bid security. This presented a risk to the EA who may not have been able to call in the bid security in the event that the bidder withdrew its bid during the bid validity period.

41. There were instances of noncompliance noted in the use of brand names in the bid documents;[28] exclusions of ADB's changes to the bid documents;[29] award of contract after validity of bid security has elapsed;[30] contracts signed despite insufficient performance securities;[31] and failure to return bid securities to losing bidders.[32]

[27] Contractor D
[28] Contract packages B1, NP1 (terminated), and NP2 (terminated).
[29] Contract package B1.
[30] Contracts NP1 (terminated) and NP2 (terminated).
[31] Contracts B1 and NP2 (terminated).
[32] Contract NP2 (terminated).

Consultant Selection

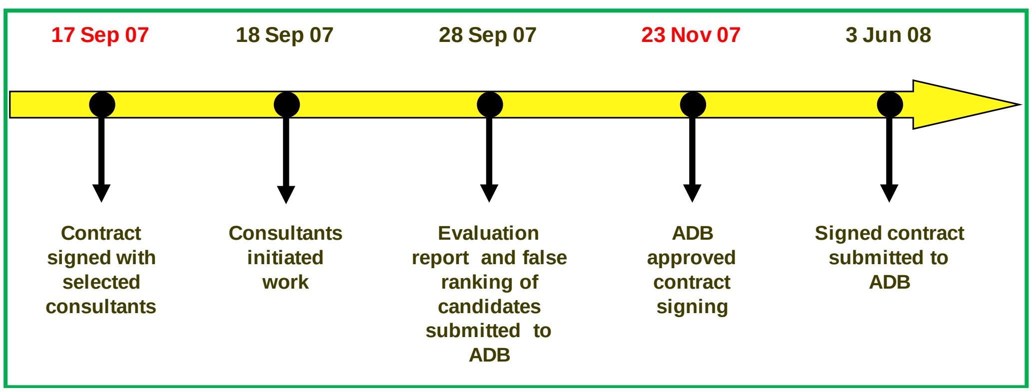
Road safety audit consultants

42. Part C – Road Safety Improvement of the Project includes the conduct of an independent road safety audit of the detailed design of the main and access roads. The PPRR team noted that the process for recruitment of two individual consultants for the road safety audit was highly irregular.[33] The evaluation report submitted to ADB was not factual. The report misrepresented that there was competition when in fact, the consultants were already selected and deployed. The evaluation report was submitted to ADB on 28 September 2007 for prior review whereas the contract was signed on 17 September 2007. ADB approved contract signing on 23 November 2007.

43. The PPRR team also observed that a copy of the signed contract was only submitted to ADB on 3 June 2008, or eight months after contract signing and at the time when the EA submitted the withdrawal application pertaining to the consultant's invoice.[34] Although the payment was processed without EATC seeking clarifications, the misrepresentation cannot be ignored.

44. **Figure 4** provides the timeline on the recruitment of the consultants. From the chronology of events, ADB's procurement rules and the Loan Agreement were contravened.[35]

Figure 4: Timeline for Recruitment of Road Safety Audit Consultants



Construction supervision consultant

45. The PPRR team reviewed the selection process for the construction supervision consultant's contract awarded to Firm A for $2.8 million.[36] The PPRR team noted issues of noncompliance by the engaged consulting firm (Firm A) to the Instruction to Consultants,[37] and

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33 PCSS 0009 Road Safety Audit ($15,000).

34 Loan Agreement, Schedule 5, 6(b) requires the EA to submit to ADB promptly after contract signing, copies of the signed contract.

35 Guidelines on Use of Consultants, para. 1.16 and Appendix 2, para. 1.3; and Consulting Services Operations Manual, para. 237 require that for all contracts requiring prior reviews, ADB should assess submissions by the borrower before they are issued. Loan Agreement, Schedule 5, para. 6(b) requires EA to submit to ADB promptly after contract signing, copies of the signed contract.

36 PCSS 0001

37 The Instructions to Consultants required only one CV to be submitted for each position, while FIRM A proposed multiple staff candidates for seven single staff positions, and input months were distributed among the candidates. Only one proposed staff candidate was evaluated.

noncompliance to ADB's *Guidelines on the Use of Consultants* with regard to the completeness of the procurement plan[38] and recording of technical quality scores when the financial proposals were opened[39].

46. The review also established that two firms that expressed interest to participate in the selection process were not evaluated by the EA for shortlisting;[40] consultant selection committee's inconsistent application of scores in regard to proposed consulting staff; and calculation error in the financial proposal resulting in overstatement, though minimal, of the contract price.[41] Exclusion of potential candidates from shortlisting without adequate justification narrows the pool of qualified consulting firms and could lead to the selection of a favored firm or a less competent one. Furthermore, inconsistent application of scores leads to questionable evaluation results. Inadequate review of key procurement documents (i.e., financial proposals and contract) may lead to overpricing, contracts with unfavorable terms and conditions, and ambiguous provisions.

47. The terms of reference of the construction supervision consultancy contract included, among others, assistance in the invitation and evaluation of contractors' proposals, which was superseded by the agreement reached during contract negotiations to exclude those contract packages already awarded. The PPRR team noted that Firm A did not assist the PMO in the procurement of civil works packages subsequent to their signing of their consultancy contract. This is noncompliant with Firm A's contract, and may have had impact on the irregularities during the procurement stages, which resulted in cancellations of some civil works contracts.[42]

48. The amendment to the contract of Firm A to extend the completion date, include price adjustment and price escalation clause, and exclude construction supervision services for contract package A (i.e., component transferred to Millennium Challenge Corporation), was delayed by one year after the completion date of the original contract. Furthermore, the PPRR team noted that a total of approximately $135,000 was paid to Firm A for the work executed during the year after the original contract had expired and the amended contract was not yet in place. Without a valid contract, the basis for authorizing and processing of payment could not be established.

Training for Semi-skilled Construction Workers and Equipment Operators

49. The PPRR team noted that the contract to train semi-skilled construction workers and equipment operators amounting to $23,000 was only executed while training was already ongoing.[43] The PPRR team did not find any documentation to justify the delayed execution of the contract.

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[38] ADB's *Guidelines on the Use of Consultants*, paragraph 1.27 stipulates that the borrower, in consultation with ADB shall prepare the procurement plan which sets forth, among others an overall indicative recruitment schedule and budget for each consulting contract package.

[39] ADB's *Guidelines on the Use of Consultants*, paragraph 2.14 stipulates that the name of the consulting firms, their technical quality scores, and the proposed prices shall be announced, and recorded when the financial proposals are opened. The two consulting firms that passed the technical evaluation were Firm A and Firm B.

[40] Firm C submitted its expression of interest to ADB on 12 April 2004, and Firm D's was received by the EA on 18 June 2004. While the deadline for submission was not clear to the PPRR team on account of lack of documentation made available, the PPRR team noted that expressions of interest were received from 12 April 2004 up to 1 May 2005.

[41] The out-of-pocket component of the financial proposal was erroneously calculated as $6,800 instead of $6,000.

[42] Refer to footnote 19.

[43] The contract was executed on 19 March 2007 and per the training output report, the training commenced on 12 March 2007.

50. Allowing a party to initiate the work without a contract opens the terms and conditions for the provision of services and basis for compensation for dispute, and provides no basis to uphold the rights or enforce the obligations of the parties to the contract. In cases of dispute, the aggrieved party would not have any recourse.

B. Financial Management

51. The PPRR team noted serious irregularities and considerable lapses in the financial management system used for the Project, including the Project's financial accounting, internal controls, and disbursement processes.

Internal controls over financial management system and disbursements

52. The significant lack of controls noted by the PPRR team can lead to unauthorized disbursements and recording errors, which may not be detected and promptly corrected, and will ultimately result in loss of Project funds. The PPRR team observed the following:

Inadequate maintenance of Project accounts

53. The Project accounts for the original loan [i.e., Loan 2087-MON(SF)] and supplementary financing [Loan 2621-MON(SF) and Grant 0199-MON(SF)] were not separately maintained – a noncompliance to the Loan Agreement and Financing Agreement.[44] However, separate audit reports for the three Project accounts were issued. The PPRR team is of the opinion that the audits were not appropriately conducted as there was no clear basis for the audit without separate Project accounts.

54. The Project accounts lacked pertinent details (i.e., date of transaction, payee's/supplier's name, check number, withdrawal application number for direct payments, and general ledger code), which hindered traceability of transactions and could result in misstatement of account balances. It could also lead to loss of Project funds (e.g., if duplicate payments are processed for a single claim or billing from the vendor).

55. Separate ledgers were not maintained for two contracts with the same contractor. Instead, the transactions were recorded in the contractor's ledger, which did not facilitate determination of contract balances.[45] Furthermore, the ledger did not adequately capture the date and description of the transactions, which made it difficult to monitor contract payment milestones.

56. Five interim payment certificates (IPCs) in 2011 relating to contract package AR1 aggregating $1,292,655.75, were not recorded by the PMO. The 2011 audited Project accounts, however, provided an updated balance for civil works contracts. It appeared that the audited figures were based on ADB's Loan and Grant Financial Information Services (LGFIS) and not on the PMO's books, which showed the absence of checks and balances as far as recording of Project transactions by ADB and the EA is concerned.

[44] Loan Agreement, Section 4.02 and Financing Agreement, Section 4.01(b).
[45] Contracts for packages B1 and AR1 were both executed by the same contractor, and only one ledger was maintained for both contracts.

Lack of information security and back-up/recovery controls over the accounting system

57. There was a lack of information security and back-up/recovery controls over the Excel-based accounting system. Project accounts were maintained by the Project Accountant using Excel spreadsheets, which were not protected against unauthorized editing of data. This exposes the Project to data manipulation.

58. It is not clear whether a back-up of the Excel-based Project accounting system is maintained. The PPRR team was informed by the Project Accountant that accounting records are backed up in her personal computer. The check register requested by the PPRR team during the planning mission in July 2012 was only provided on 21 September 2012, which came from the Project Accountant's personal computer. The check register had no details relating to 45 checks issued. The PPRR team was also informed that the check register maintained by the PMO was destroyed by a computer virus. Without official back-up of the accounting system the Project is exposed to the risk of loss of Project information.

Erroneous accounting

59. The PPRR team noted that PMO salaries aggregating $12,878 were erroneously taken up under different expense accounts (i.e., stationery, communication and courier, and other expense). This type of error could have been caused by lack of review of the journal entries prepared by the Project Accountant before these were posted to the general ledger. Inadequate review of accounting entries can lead to misstatement of expenditures in the books of accounts.

Irregular disbursement of salaries and advances to PMO staff

60. The PPRR team noted that salary payments to PMO staff members were inconsistent with their employment contracts.[46] The Project Accountant explained that while salary amounts are reflected in PMO staff contracts, salaries are paid based on the quarterly budget approved by the EA and MOF.[47] Without employment contracts of some PMO staff for certain years and documentation on how individual increases based on the approved budget were computed, the PPRR team could not validate the accuracy of staff salaries.

61. While salaries of PMO staff were supposed to have been paid on a monthly basis, the PPRR team noted that these were made at irregular intervals (i.e., between 10 to 77 days from the last salary payment). Those salary payments exceeding the monthly interval were instances when two months' salaries were combined and paid on the second or succeeding month.

62. The process and documentation requirements for salary advances were not clear. The following issues were noted:

a. Salary advances did not have any supporting documents to signify that these were authorized.

b. The payment requests signed by the Project Accountant and then Project Director (Project Coordinator starting 2012), PMO to withdraw from the imprest

[46] Contracts for some PMO staff for certain years were not provided to the PPRR team.
[47] The PPRR team was informed by the Project Accountant about the upward revision in salary structure per Resolution No. 86 dated 14 April 2011.

account did not indicate that these were for salary advances but merely indicated "salary – PMO" as general reason for the request.

c. The payment request and check only provided the name of the person authorized to withdraw the amount requested. There was no documentation made available to the PPRR team that identified who had received the advance.

d. Advances were not appropriately recorded in the Project accounts. These were recorded as salaries, and hence did not reflect the actual transactions.

e. An advance was returned subsequent to payment of salaries for the specific period. However, none of these transactions were recorded in the Project accounts.

Civil Works

Delay in payment to contractors

63. The PPRR team noted delays in payment of mobilization advances to contractors[48] of civil works packages AR1, B1 and NP1 by 36, 49 and 57 working days, respectively. Withdrawal application for mobilization advance for AR1 was filed just 3 days before the due date of release of the advance. For B1 and NP1, the withdrawal applications were filed 18 and 8 days after their respective advance payment due dates. These payment delays could unnecessarily impede Project implementation.

Consultants' Contracts

Payment of potentially ineligible expenditures

64. The PPRR team noted instances where potentially ineligible expenditures amounting to $51,569 were claimed by the construction supervision consultants and paid out of the Project funds.[49] These pertained to the following:

(i) Expenses not specified in the contract:

- International travel of a consultant's dependent not specified in the consultancy contract ($2,800);[50]

(ii) Expenses without adequate supporting documentation[51]:

[48] The General Conditions of Contract, paragraph 14.7(a) require the employer to pay the contractor the first installment of advance payment within 42 days after issuing the Letter of Acceptance or within 21 days after receiving documents in accordance with sub-clause 4.1 (Performance Security) and sub-clause 14.2 (Advance Payment), whichever is later.

[49] Ineligible expenditures in this report pertain to payment of: (i) expenses not specified in the contract; (ii) expenses without adequate supporting documentation; and (iii) non-Project-related expenses.

[50] PMO clarified that while the international travel of a consultant's dependent was not considered during contract negotiations, the consultant and MRT subsequently agreed, on a verbal basis, to allow payment for the international travel of a consultant's dependent when the consultant has been mobilized for more than three months without breaks. Without appropriate documentation to support payment of the dependent's international travel, the PPRR team considers this as ineligible expense.

[51] The consultancy contract for construction supervision dated 11 August 2006, Article VI, Section 6.05(d) requires the consultant to submit to MRT itemized statements, accompanied by receipted invoices, vouchers and other

- Roundtrip flights ($23,115.) and train travel ($657) of consultants not appropriately supported to confirm that the trips were actually taken;[52]

- Unsupported claims for expenses under ‘Provisional Sum and Contingencies’ ($3,285);[53]

- Office and computer equipment for PMO without authorization to purchase and/or official receipts ($3,063).[54]

(iii) Non-project-related expenses:

- Excess payment of a consultant’s remuneration ($1,360);[55]

- Rental of office space for PMO of Component A from 2010 to 2012 after funding and implementation of the component were taken over by the Millennium Challenge Corporation in 2010 ($15,855);[56]

- Tax paid for rental of PMO office spaces for 1 October 2010 to 1 October 2011 ($1,435);[57]

65. Payment of ineligible expenses indicates that the claims were not properly reviewed to ensure compliance with the contract terms and ADB’s *Loans Disbursements Handbook*. The lack of appropriate oversight in processing payments could result in waste of Project funds.

Inadequate and inconsistent supporting documents

66. The PPRR team noted that the documents maintained by the PMO in regard to office space rental paid out of the construction supervision consultant’s (i.e., Firm A) contract were unclear and inadequate. There were lease agreements for certain periods that were not made available to the PPRR team, and with overlapping periods. The PPRR team was not able to validate the accuracy of Firm A’s claims for PMO rental without the following: (i) lease

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appropriate supporting materials, of the amounts payable to the consultant when filing monthly billings. Section 6.09 provides that the portion of the monthly statement that is not satisfactorily supported may be withheld from payment.

52 Although supporting documents for the roundtrip flights and train travels were not provided, the PMO, in its response to the preliminary draft report, confirmed that these trips were indeed taken. PMO assured that it will require the consultant to submit validated travel documents in its subsequent claims.

53 PMO provided the breakdown and description of expenses claimed under ‘Provisional Sums and Contingencies’ but not the supporting documents. $1,600 of these expenses pertained to duplicate claim of office rental for which PMO will seek refund from the consultant.

54 PMO subsequently provided the PPRR team with copies of documents supporting payments for some of the office and computer equipment. However a total of $3,063 did not have the authorization to purchase and/or official receipts.

55 PMO agreed to ask the consultant to refund the amount.

56 PMO explained that the office space in question was utilized by the Project from 1 February 2010 up to 1 March 2012. PMO added that during this period, the Project had a number of contractors and needed the extra office space for meetings. The PPRR team could not validate this explanation. Considering that the civil works were stalled during this period and that the contractors were based in Sainshand, it appears that the justification to maintain two office spaces for the PMO was unreasonable.

57 PMO agreed that tax on office rental was paid to the lessor and advised the PPRR team that the same will be deducted from the 2013 office rent payable.

agreement, (ii) PMO's request for Firm A to pay the rental, and (iii) lessor's invoice for certain rental periods

67. The lack of adequate supporting documentation did not facilitate checking of accuracy of payments for PMO office space rental, and poses a risk of Project funds being wasted.

PMO expenses paid out of loan allocation for PMO and construction supervision consultancy contract

68. The minutes of contract negotiations for the construction supervision consultancy contract required the consultant to provide PMO with facilities, supplies, and office space under 'Provisional Sum and Contingencies.' The PPRR team is not clear why PMO-related expenses, which have specific loan allocations (i.e., categories 06 and 02 for Loans 2087-MON(SF) and 2621-MON(SF), respectively), are also paid out of the consultancy contract.[58] The PPRR team noted that there were PMO expenses of similar nature that were paid out of the consultancy contract and the loan allocations for PMO expenses.[59]

69. While funding of PMO-related expenses comes from two separate sources, namely PMO allocation and consultancy contract, the type/nature of expense and period chargeable to the PMO allocation and consultancy contract's Provisional Sums and Contingencies were not specified. This practice provides opportunities for abuse and duplicate claims of Project expenses, and prevents prompt detection of integrity violations.

Noncompliance to contract – period of recovery for advance payments and filing of claims

70. The PPRR team noted that the full recovery of advance payment of $220,192.50 to Firm A was delayed by five months, which was not compliant with the contract requirement.[60] It was explained to the PPRR team that the Project Accountant and Firm A misunderstood the contract requirement to mean that the advance payment was recoverable in the first 20 installments instead of within the first 20 months of services.

71. The PPRR team also observed that billings by Firm A were not filed monthly and a single billing covered multiple months. This practice is not aligned with the billing procedure defined in the contract which requires Firm A to file claims within 15 days after the end of each calendar month.

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58 Loan 2087-MON(SF) and supplementary Loan 2621-MON(SF) provided an aggregate allocation of approximately $0.6 million equivalent for project management. Of this amount, about $0.23 million from both loans is undisbursed as of PPRR cut-off date. At the same time, the consultancy contract for Firm A provides for the consultant to maintain, among others an office space and all required facilities (e.g., communication and transportation costs, office furniture, etc.) for PMO office staff to smoothly run the project management activities in Ulaanbaatar (ref. Appendix A – Terms of Reference, paragraph D of the consultancy contract dated 11 August 2006. The Minutes of Contract Negotiations of August 2006, paragraph 7 "Facilities and Supplies for Project Management Office" amplified that these facilities, supplies and office space for PMO to be provided by the consultant shall be funded out of the Provisional Sum, Equipment).

59 While all PMO staff salaries, mobile expenses of Project Managers for PMOs of both ADB component and EDCF-Korea Component for 2005 – 2006, garage expenses for 2005-2006, and furniture and equipment were paid out of the loan allocation for PMO expenses, there were also PMO-related expenses [i.e., mobile phones and subscription payments, all PMO office rentals, transportation expenses (fuel, driver's salary, vehicles parts and repairs, garage), furniture and office equipment] that were claimed and paid for out of Firm A's contract.

60 Clause 6.03 of the construction supervision contract provides for the recovery of the advance payment within the first 20 months of services until fully collected.

Concerns on the quality of audited Project accounts and use of SOE procedures

72. Given the irregularities noted on the financial management system and the sample disbursements reviewed, the PPRR team is concerned that the annual audited project accounts and use of statement of expenditures (SOE) procedures provided unqualified opinion but did not include any internal control findings. The internal control gaps should have been promptly identified and addressed by the annual audits.

Internal Controls

Inadequate capacity of the Project accounting team

73. The noted irregularities in the review of financial management and disbursements generally resulted from lapses in the processing, review, and approval of disbursements. The Project Accountant performs four incompatible functions namely: (i) handling of blank checks (custody of assets function); (ii) approving checks and direct payments as secondary signatory (authorization function); (iii) recording of transactions and maintenance of Project accounts (recording function); and (iv) reconciling Project accounts with bank records and ADB records (control function). The Project Coordinator, PMO approves checks as primary signatory. There is no assurance that transactions are appropriately reviewed by a third party for accuracy, completeness of supporting documents, and prompt recording. The importance of checks and balances in payment procedures cannot be ignored.

74. The PPRR team did not find the Quantity Surveyor's certification in the measurement sheets attached to some IPCs for civil works package B1. The PPRR team also noted that IPC 5 for package AR1 amounting to $122,439 was not signed by the Project Coordinator. As the proof of review by Project officers concerned was not evident in these documents, the PPRR team could not validate whether the review was performed.

Non-periodic bank reconciliation of imprest account

75. Monthly bank reconciliation was not performed for the imprest account, but only prepared as a supporting document when liquidation is filed and replenishment is requested from ADB. This makes establishing the correct cash balance at month-end difficult. Furthermore, unauthorized disbursements will not be detected until it is too late.

Inadequate maintenance of PMO asset register and lack of periodic inventory of assets

76. From 2005 to date, assets (e.g., computers, fax machines, furniture, cameras, scanners, notebooks, coffee machine, GPS, etc.) amounting to approximately $25,834 were purchased for the PMO. A total of $13,300 was funded from the PMO allocation through the imprest account and $12,534 from the consultancy contract. The PPRR team noted that while an asset register was maintained by the Project Accountant for assets purchased out of the imprest account, the list of assets purchased by Firm A was incomplete.[61] The asset registers did not include the names of the assignees, location of the assets, acquisition details and status (e.g., in use/active, lost/stolen, damaged, for repair). Furthermore, there was no periodic inventory to confirm existence and physical status of the assets, including accuracy of the registers.

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[61] The list of assets purchased by Firm A for PMO was provided to the PPRR team at a much later date during the fieldwork.

Asset Verification

77. The PPRR team, through its engineer, inspected the works under two civil works contracts,[62] and found that these were generally of acceptable quality, in good condition, at the appropriate location, and used for intended purposes. However, there were issues identified on the designs and technical specifications. On-site inspection and materials testing revealed defects, some deviations from approved designs, and substandard materials in some areas. These deviations and defects noted are highlighted below.

a. *Adoption of thinner pavement design (Contract package B1).* Due to budget considerations, a thinner pavement than initially proposed by the design consultant was adopted. This was a transition-type pavement requiring rehabilitation every 4-5 years during operation.

b. *Substandard materials in some areas (Contract package B1).* Based on the overall testing by the PPRR engineer, it was concluded that in some road sections, the sub-base and non-frost layer were unstable for the intended purpose and climatic site conditions.

c. *Construction defects failures (Contract package B1).* These include, among others, pavement failure in several locations; poor compaction of shoulders and embankment; misplaced and defective road furniture; poor and non-standard fitting of guard rails; and poor alignment and construction methods of the side drains.

DETAILED RECOMMENDATIONS

78. EARD is requested to ensure recommendations are appropriately implemented and to periodically update OAI with implementation status thereof.

79. The PPRR team requests that the EA and PMO cooperate and support OAI in future investigations on potential integrity violations identified in this PPRR.

A. Procurement

80. The lack of key procurement-related documents is a serious irregularity and breach of the Loan Agreement, which EATC agreed. It is recommended that EATC provides a stern warning to the EA about the serious repercussions for breaches of the Loan Agreement. As such, the EA should ensure all Project-related documents are kept safe throughout the life of the Project, and implement a procedure to monitor the movement of Project documents, improve accountability, prevent misplacement, and ensure availability when required (paras. 31-32).

81. The procurement process leading to the award of contract for the road safety audit was highly irregular and the evaluation report contained misrepresentations. This contract should

[62] Contract packages B1 ($23.9 million) for construction of 131.3 km road section between the 35th railway crossing and 18th Khudag (well) and AR1 ($2.3 million) for construction of a 15.5 km access road from the Project main road to Erdene Soum.

not be funded by ADB. Hence, EATC in coordination with CTL should seek refund of $15,000 paid from the loan funds (paras. 42-44).

82. For the remaining life of the Project, and future development projects in Mongolia involving the same EA, the PPRR team recommends that MRT and the PMO intensify its oversight of the procurement exercise and ensure:

a. that the evaluation committee

- be equipped with necessary technical skills to evaluate bid submissions, and to carefully assess bidders on their compliance with the bid requirements with utmost impartiality and transparency (paras. 36 and 38);
- exercises due diligence on the bid submissions at all times in order to validate bidders' submitted information and supporting documentation (paras. 36-37);
- takes more care in preparing comprehensive evaluation reports, which clearly state the results of assessment of each bidder for each criterion, and with results fully substantiated to enable ADB to provide appropriate no objections (para. 39); and
- takes into account all ADB revisions to the standard bidding documents before these are issued to the bidders (para. 41).

b. that the consultants selection committee (paras. 45-46)

- provides appropriate ratings in evaluating consultants;
- complies with ADB's *Guidelines on the Use of Consultants* by recording the technical quality scores in the record of financial opening, and require prospective consultants to comply with the Instructions to Consultants (e.g., submission of one proposed candidate for single positions);
- includes all EOIs in shortlisting candidates; and
- reviews the consultants' proposals at all times to ensure accuracy of submitted information.

c. compliance to ADB's Procurement Guidelines, specifically on not using brand names in bid documents, non-acceptance of invalid bid and performance securities, and returning of bid securities to losing bidders (paras. 40-41).

d. that bid requirements are explained to the bidders, possibly during the pre-bid meeting, so that these are appropriately understood and consistently applied (paras. 40-41).

e. that procurement-related decisions are documented to ensure transparency and to provide appropriate audit trail (para. 39).

83. The PMO should ensure that contracts and/or subsequent amendments thereto are appropriately executed prior to the commencement/extension of services, works and/or delivery of goods. In instances where delayed execution is imminent and that the timely delivery of services, works or goods is crucial to the Project, such should be sufficiently justified and documented, and appropriate approvals obtained (paras. 48-50).

84. The PPRR team also recommends that EATC:

a. ensures that the EA and its evaluation committee understand how to assess the bidders' financial resources[63] (para. 36).

b. exercises due diligence with respect to the prior review requirement of procurement documents. In particular, evaluation reports for high-risk, high-value, and problematic contracts should be scrutinized carefully and information therein should be selectively validated against bids submitted based on EATC's assessment of the EA's capacity for procurement (para. 39).

B. Financial Management and Disbursements

85. It is recommended that the PMO:

a. maintains separate Project accounts for the Loan and the supplementary Loan and Grant in compliance with the Loan and Financing Agreements (para. 53).

b. provides the relevant details of transactions in the general ledger (e.g., date of transaction, payee's/supplier's name, check number, withdrawal application number, general ledger code) to facilitate traceability, establish correct account balances, and prevent loss of Project funds resulting from duplicate payments (para. 54).

c. creates a separate ledger for each contract which should promptly capture, among others, the date, description of transactions, and amount to readily determine each contract account balance and monitor payment milestones (paras. 55-56).

d. strengthens information security (e.g., use of passwords and locking of accounting formula) and back-up/recovery controls over the Excel-based Project accounting system to safeguard from creation of fictitious transactions, unauthorized modification of data, and to prevent data loss. Together with MRT, the PMO should also consider automating the accounting system that would include built-in controls and facilitate efficient processing of transactions (paras. 57-58).

e. appropriately adjusts misclassified expenses noted by the PPRR team. Reviewing journal entries will ensure expenses and other transactions are properly recorded (para. 59).

f. institutes appropriate procedures and arrangements for salary payments, including advances of PMO staff to ensure that salaries are accurately paid at regular

[63] The latest standard bidding document from the User's Guide for Procurement of Works updated in August 2012 provides that the bidder must demonstrate access to or availability of, liquid assets, lines of credit, or other financial resources (other than any contractual advance payments) to meet the Bidder's financial resources required.

intervals, and advances are authorized, properly documented, and promptly recorded (paras. 60-62).

g. ensures mobilization payments comply with the payment terms stipulated in the contract to avoid unnecessary implementation delays. Furthermore, the PMO should ensure understanding of contract requirements, specifically on recovery of advance payments within the required period, and strictly implement monthly billings by the construction supervision consultants (paras. 63, 70-71).

86. It is recommended that EATC, in coordination with CTL take necessary steps to confirm ineligible expenditures noted, and seek refund from construction supervision consultants, where warranted (paras. 64-65).

87. To ensure that duplicate payments are not made for PMO-related expenses, the PPRR team recommends that EARD and MRT identify which types of expenses are chargeable to the PMO allocation and which ones are chargeable to the construction supervision contract's Provisional Sums and Contingencies. In future loans, it is recommended that EARD cautiously review loan allocations and provide appropriate budget for PMO-related expenses. Charging of these expenses to supervision consultant's contracts should be discouraged (paras. 68-69).

88. It is recommended that EATC, in consultation with MRT and OSFMD, assess the quality of the audit reports and revisit the terms of reference of the external auditors to include a management reporting requirement that should contain audit findings, recommendations and management responses. This will ensure the quality of audits of project accounts and use of SOE procedures, and enable the EA to promptly address the findings and prevent adverse impact on the Project (para. 72).

C. Internal Controls

89. The capacity of the Project accounting team should be significantly strengthened. The PPRR team recommends that the EA, in coordination with EATC, revisit the capacity (i.e., staffing and qualifications) of the Project accounting team to ensure that transactions are accurate, appropriately supported, and promptly recorded. All transactions should be reviewed and approved by the PMO Coordinator (para. 73).

90. The deficient review and oversight of the disbursements process by the PMO resulted in erroneous classification of expenses, irregular salary payments for PMO staff, and payments of ineligible expenditures, among others. The lack of segregation of duties in the disbursements process leads to erroneous payments and recording errors, including non-detection of integrity violations. Furthermore, the lack of controls over asset management can result in undetected loss of assets and unrepaired damaged assets. It is recommended that PMO:

- conducts due diligence on the supporting documents substantiating the disbursements so that payments are only made for eligible and appropriately supported claims. Review of documents should be appropriately documented by signing the relevant forms (paras. 64-67, 74).

- performs monthly bank reconciliations of the imprest account to determine the correct cash balance at month-end and to detect unauthorized disbursements (para. 75).

- o adequately maintains a register of all PMO assets which includes the names of the assignees, location, acquisition details and status (e.g., in use/active, lost/stolen, damaged, for repair) of the assets. A periodic inventory count should be conducted to establish existence and physical state of the assets and accountability of assignees. The results of the inventory should be appropriately documented in the asset register (para. 76).

D. Asset Verification

91. The technical integrity of any project is based on the designs and standards adopted. The PPRR team recommends that EARD, MRT and the PMO ensure that all future technical specifications should be clear so that only suitable materials are used.

92. Insofar as shortcomings in the execution of works are concerned, it is recommended that MRT and the PMO work closely with the construction supervision consultants and contractor to ensure that the defects and failures noted during the PPRR are appropriately rectified prior to the expiry of the defects liability period and before the retention money is repaid in full to the contractor. Further detailed testing of randomly selected failed pavement locations should be conducted as appropriate, to determine the extent of the defects and causes of the failure.

93. EARD, MRT, the PMO and construction supervision consultants should enhance Project oversight to ensure that the defects noted do not happen in the remaining subprojects.