



Follow-Up Review of PPRR Recommendations

Loans 2783-PNG and 2784-PNG(COL): Bridge Replacement for Improved Rural Access Sector Project

Office of Anticorruption and Integrity

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This is a redacted version of the document, which excludes information that is subject to exceptions to disclosure set forth in ADB's Access to Information Policy.

Asian Development Bank



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CURRENCY EQUIVALENTS

Currency unit	–	Papua New Guinea Kina (PGK)
1 PGK	=	\$0.307599546
\$1.00	=	PGK 3.252033

ABBREVIATIONS

ADB	-	Asian Development Bank
CSTB	-	Central Supply and Tenders Board of Papua New Guinea
DoW	-	Department of Works and Implementation
GoPNG	-	Government of Papua New Guinea
IPC	-	Interim Payment Certificate
NEC	-	National Executive Council of Papua New Guinea
OAI	-	Office of Anticorruption and Integrity
PARD	-	Pacific Department
PIU	-	project implementation unit
PNRM	-	Papua New Guinea Resident Mission
PPFD	-	Procurement, Portfolio and Financial Management Department
PPRR	-	project procurement-related review

NOTES

- (i) The currency equivalents used were as at 31 March 2018, the PPRR cut-off date.
- (ii) In this report, \$ refers to US dollars.

Project Procurement-Related Reviews

Mandate:

ADB's *Anticorruption Policy* requires all parties, including borrowers, beneficiaries, bidders, consultants, suppliers, contractors, and ADB staff to observe the highest ethical standards when participating in ADB-related activities. The Policy supports ADB's obligation, under 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 Office of Anticorruption and Integrity (OAI) conducts project procurement-related reviews (PPRRs) or proactive project integrity risk reviews to help prevent and detect integrity violations (i.e., fraud, corruption, collusion, coercion, abuse, conflict of interest, and obstruction).

Objective:

A PPRR assesses project integrity risks through the (i) examination of processes, procedures, and documentation related to procurement, financial management, and contract implementation/management, and (ii) inspection of project outputs. OAI recommends enhancements to mitigate or eliminate opportunities for integrity violations.

OAI conducts follow-up reviews on PPRRs to (i) assess the implementation progress of the PPRR recommendations, and (ii) assist the executing/implementing agencies and ADB in implementing any remaining recommendations.

A PPRR is neither an investigation of fraud and corruption nor 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 completion of a project.

EXECUTIVE SUMMARY

In 2016 the Office of Anticorruption and Integrity (OAI) of the Asian Development Bank (ADB) conducted a project procurement-related review (PPRR) of the Bridge Replacement for Improved Rural Access Sector Project (the Project) in Papua New Guinea. The Project is financed through loans 2783-PNG (USD 40 million) and 2784-PNG (USD 50 million), both approved in 2011. In 2018 OAI performed a follow-up review to establish whether the PPRR recommendations were implemented.

The 2016 PPRR resulted in high-risk and medium-risk findings that compromised the integrity of the Project. OAI made 14 recommendations to improve overall implementation controls and construction supervision and mitigate integrity risks in procurement and financial management. Specifically, the recommendations intended to:

- (i) strengthen the procurement and financial management capacity of the project implementation unit (PIU) and Papua New Guinea Resident Mission (PNRM);
- (ii) reinforce institutional accountability through improved records management;
- (iii) enhance transparency and fairness in procurement, and ensure compliance with ADB policy and procedures;
- (iv) safeguard project funds from misuse and recover overpayments; and
- (v) improve supervision over contract implementation to align disbursements with physical progress.

OAI conducted a follow-up review on nine of the 14 recommendations. The remaining five recommendations could not be reviewed due to the lack of review samples and the absence of any ongoing civil works. To assess the implementation status of recommendations, OAI reviewed a sample of disbursement transactions of the contracts within the review period (April 2016 to March 2018).

The follow-up review concluded that the DoW did not implement most of the assessed recommendations, and that the project was still exposed to the risks identified in 2016. Of the nine recommendations, two were implemented, two were partially implemented and five were not implemented. Recommendations to include all sources of funds in the project financial statements, and to eliminate inconsistencies in a consultancy contract were implemented. The partially implemented recommendations concern records management and the validation of claims. Recommendations to enhance the PIU's financial management capacity, to monitor works implementation progress vis-à-vis disbursements, to recover payments for ineligible expenses, to clarify the basis of payment for out-of-pocket expenses, and to reflect changes in payment provisions in the contracts were not implemented.

Due to non-implementation of 2016 PPRR recommendation to recover payments for ineligible out-of-pocket expenses and partial implementation of recommendation to validate payment claims, the amount of unsupported – and therefore ineligible – payments for out-of-pocket expenses to a consulting firm increased to the equivalent of USD 1,762,669.

During the follow-up review, OAI assisted the PIU to develop action plans to implement the outstanding procurement recommendations. OAI also made three new observations: overpayment by ADB due to incorrect interim payment certificates, variation orders exceeding 15% of contract price without ADB approval, and the inappropriate handover of materials from the contractor to the executing agency upon contract termination. The follow-up review also noted

that the termination of a civil works contract resulted in overpayment of PGK 5,489,416 (equivalent to USD 1,687,995) to the contractor.

OAI reiterates its recommendations that:

- (i) ADB Pacific Department (PARD) and PNRM follow through the recommendations identified in this report, organize targeted workshops, and conduct frequent review missions;
- (ii) PARD closely reviews disbursements, takes action to suspend payments and ensures recovery of the ineligible expenditures from the supervision consultant; and
- (iii) DoW strengthens the financial management systems and internal controls across all levels and throughout project implementation.

The practice of varying and adjusting conditions of contract, including payment conditions, is not properly monitored or documented by the PIU and PNRM and poses a serious integrity risk. OAI therefore recommends that the PIU and PNRM increase their level of due diligence in contract management. The outposting of an ADB procurement expert to PNRM has been a positive step to strengthen the national procurement capacity, and this should be supplemented with building PNRM's contract management expertise.

Considering the significance of the 2016 PPRR recommendations that were not implemented or were only partially implemented, and the additional observations made during the 2018 follow-up review, OAI recommends that PARD and PNRM supervise DoW's and PIU's procurement, financial management and contract implementation processes in current and future projects more closely. The closer supervision should continue until such time that DoW implements the 2016 PPRR and 2018 follow-up review recommendations and takes steps to effectively eliminate the recurrence of the issues identified.

I. OVERVIEW

1. In 2016, the Office of Anticorruption and Integrity (OAI) of the Asian Development Bank (ADB) conducted a project procurement-related review (PPRR) on the Bridge Replacement for Improved Rural Access Sector Project (the Project) in Papua New Guinea.¹ **Table 1** shows the Project background.

Table 1: The Project At a Glance

Total project cost	USD 100.0 million
ADB funding	USD 90.0 million
GoPNG funding	USD 10.0 million
Project Description	The Project will improve Papua New Guinea's (PNG) two-lane national road network by replacing narrow temporary modular steel and other deteriorated bridges with permanent two-lane structures. The reusable modular steel bridges will be reassembled on rural roads to improve access.
Project Impact	The rural population in selected provinces has improved access to markets and social services
Project Outcome	The road network in rural areas of selected provinces is better connected, more efficient and safer
Executing Agency	Department of Works and Implementation (DoW)
Implementation Unit	Project Implementation Unit (PIU) established within DoW
Major project components	Package 1 – Construction of six bridges along Magi & Hiritano highways, Package 2 – Construction of 12 bridges along New Britain highway
Status as of 31 March 2018	Package 1 – Civil works were completed, defects liability period was ongoing Package 2 – Civil works were partially completed, construction temporarily suspended due to termination of contract. Selection of a new contractor to complete the works was ongoing

2. OAI conducted a follow-up review in 2018 to: (i) assess the implementation status of the PPRR recommendations; (ii) assess the effectiveness of the actions taken by the executing agency – the Department of Works (DoW), project implementation unit (PIU), and ADB Papua New Guinea Resident Mission (PNRM); and (iii) assist the PIU in resolving pending issues and developing action plans to implement the remaining recommendations. Further document review and analyses were completed at ADB headquarters after the fieldwork.²

3. OAI examined relevant documents and transactions for two civil works and two consulting services contracts that were also reviewed in the 2016 PPRR.³ The follow-up review covered the activities and transactions from the end of PPRR fieldwork in April 2016 to 31 March 2018.⁴

¹ Financed by Loans 2783-PNG and 2784-PNG(COL).

² OAI conducted the fieldwork in Port Moresby from 30 April to 11 May 2018. Subsequent to the fieldwork, OAI further reviewed and analyzed documents at ADB Headquarters, primarily to assess the financial impact of the follow-up review results.

³ The redacted version of the 2017 PPRR report is available on ADB's website: <https://www.adb.org/sites/default/files/project-documents/43200/43200-024-pprr-en.pdf>

⁴ This is based on the financial transactions recorded in ADB's Loan and Grant Financial Information Services system as of the review cut-off date.

4. The scope of the follow-up review is limited to assessing the implementation of 9 of the 14 PPRR recommendations, because:

- (i) no new civil works contracts were signed during the review period and therefore OAI could not assess the implementation of four recommendations on the improvement of the PIU's procurement procedures and documents;⁵
- (ii) at the time of the follow-up review fieldwork, there was no ongoing civil work and therefore OAI could not assess the implementation of the recommendation on improving asset management.

II. RESULTS

5. OAI confirms that of the nine recommendations reviewed, two were implemented, two were partially implemented and five were not implemented.

6. In the 2016 PPRR, the review team noted payments to a consulting firm on a lumpsum basis for out-of-pocket expenses, which per contract were reimbursable at cost. The finding resulted in three recommendations. The follow-up review established that one recommendation was partially implemented (see paras. 14-15), and the two others were not implemented (see paras. 19-21 and 24).

7. During the period covered in the follow-up review one of the civil works contracts was terminated by mutual agreement of the DoW and the contractor.⁶ This resulted in overpayment of PGK 5,489,416 (equivalent to USD 1,687,995) to the contractor, caused by (i) the advance payment in excess of the contractually agreed rate (see paras. 22-23), (ii) irregularities in interim payment certificates (IPC) (see paras. 32-33), and (iii) inadequate monitoring of disbursements vis-à-vis contract implementation (see paras. 17-18).⁷

A. Implemented recommendations

8. The recommendations implemented by the PIU are presented below.

9. **Project financial statements include all sources of funds.** The PIU implemented the PPRR recommendation to include both ADB and Government counterpart portions of financing and use of funds. This was confirmed through the review of the audited project financial statements for 2016.⁸ During the 2016 PPRR, the project financial statements for 2014 and 2015 contained only the Government counterpart funds.

10. **Accommodation provision aligned with field service duration.** The DoW and the consultant signed a contract variation to change the number of field service months from 11 to 12

⁵ At the time of the follow-up review fieldwork, rebidding for one civil works contract was ongoing. As the procurement process had not been completed, it was not included in the scope of the follow-up review.

⁶ The termination followed prolonged disputes during the contract implementation. The main reason was the disagreement between the contractor and the supervision consultant on variation orders, which resulted in IPC processing delays. At some stage the contractor used the contract provisions to impose partial suspension of works, leading to full suspension, and finally to termination of the contract.

⁷ At the time of termination, the contractor had a counterclaim, which the supervision consultant had not certified in its entirety, and which the parties could not resolve.

⁸ The latest set of audited financial statements for the Project at the time of the fieldwork.

and thus align the number of months for accommodation provision with the number of field service months.⁹

B. Partially implemented recommendations

11. The PIU and PNRM acted on the recommendations but did not fully implement them. Additional actions are required as explained below.

12. **Improve records management.** The PIU staff attended the ADB records management training in August 2017, and PNRM assisted the PIU in organizing project documents. The PIU keeps project records in a dedicated filing room, where files are organized and labeled to facilitate retrieval. While the records management protocol has improved, the PIU was unable to provide some documents requested for review, such as some withdrawal applications, variation orders, detailed BOQs and lists of materials to support IPCs, as well as handover certificates upon completion of civil works/termination of contract.

13. Failure to appropriately maintain project records (i) reduces transparency and accountability in procurement and financial management; (ii) precludes the DoW and PIU from supporting their decisions; and (iii) creates opportunities to commit and conceal irregularities. Hence, further improvements are required to ensure that all documents are properly filed, accounted for, and that all movements of project documents are consistently recorded.

14. **Validate payment claims against contracts and supporting documents.** Nine of ten consultant invoices reviewed were supported by the time sheets of individual experts of the consultant's team. However, the consulting firm continued to claim on a lumpsum basis for out-of-pocket expenses, which per contract are reimbursable at cost and require documentary support. As of 31 March 2018, the PIU submitted payment requests for out-of-pocket expenses totaling USD 1,602,697 plus PGK 520,234 to ADB, and ADB processed the payments. Thus, the PIU did not address the 2016 PPRR recommendation.

15. These ineligible or excessive payments to consultants constitute a possible misuse of funds and give rise to integrity concerns. The PIU should rigorously scrutinize contractor and consultant claims against contracts and supporting documents. PNRM should implement a procedure of reviewing the consulting firm's claims before ADB's payment and ensuring that all expenses are substantiated.

C. Recommendations that are not implemented

16. The executing agency and PNRM did not implement five recommendations or take sufficient actions to resolve the underlying issues.

Financial Management and Disbursements

17. **Closely monitor disbursements vis-à-vis contract implementation progress.** During the 2016 PPRR, it was noted that 60% of the contract amount for one of the civil works contracts had been disbursed, whereas the estimated physical completion was 10%. In 2018 the disbursements under this contract had increased to 79% of the contract amount, whereas the physical progress was 58% per the latest report of the supervising engineer.¹⁰ The assessment

⁹ The PPRR had also recommended to include a clause on pro-rated calculation of accommodation provision for partial months. The recommendation became irrelevant due to completion of contract.

¹⁰ Monthly report of the supervising engineer (January 2017).

of physical progress by OAI's engineer, based on the inspection of eight bridges, was 54%, while there had been no significant civil works on the remaining four bridges under the contract.¹¹ Whilst the gap between disbursements and certified physical progress appears to have reduced, it still remained significant. At the time of the follow-up review, the DoW and the contractor had terminated the contract, following a prolonged period of disputes related to the contract implementation.¹² The mismatch between the disbursements and the physical progress resulted in overpayment of PGK 5,489,416 (equivalent to USD 1,687,995) to the contractor.

18. OAI recommends that for future contracts the DoW, PIU and PNRM closely monitor project implementation and ensure that the disbursements, as compared with the physical progress, remain within a reasonable range and are fully in compliance with contract provisions.¹³

19. **Recover payments for ineligible expenses.** The PPRR recommended to recover lump sum payments to the consultant for out-of-pocket expenses, that were made without supporting documents, whereas per contract they should have been paid at cost with relevant supporting documents. Since the issuance of the PPRR report, the consultant continued submitting payment claims on a lumpsum basis, which PIU endorsed as eligible and submitted to ADB for payment. Due to PIU's acceptance of the claims, the total amount to be recovered from the consultant increased from USD 890,075 plus PGK 152,800 at the time of PPRR to USD 1,602,697 plus PGK 520,234 as of 31 March 2018.

20. The PIU did not take effective actions to address the 2016 PPRR recommendation. The PIU management stated that the PIU could not recover these payments as the consultant did not agree that the basis of payment for the expenses is "at cost".

21. OAI recommends that PARD immediately takes action to suspend payments and ensures that DoW recovers any ineligible expenditures from the consultant.¹⁴

22. **Implement contract variations to reflect changes in payment provisions.** The 2016 PPRR noted that for two civil works contracts, advance payments of 20% of the contract amount were made, whereas the contracts specified 10%. The DoW did not implement the PPRR recommendation to reflect the changed advance payment rates, nor the advance payment recovery rates in the contracts through amendments. At the time of the follow-up review, the works under one of the contracts had been completed, and the advance payment had been fully recovered from the contractor. However, the second contract has been terminated, and the elevated advance payment contributed to overpayment of PGK 5,489,416 (equivalent to USD 1,687,995) to the contractor.

23. OAI reiterates its recommendation for the PIU to seek ADB's approval and execute contract amendments whenever there are changes in commercial terms. PNRM should verify the PIU's compliance with this requirement through the review of withdrawal applications. Where

¹¹ Date of site visit: 6 May 2018

¹² The latest IPC issued by the supervision consultant covered the period until November 2016; the contract was terminated in August 2017.

¹³ In the response to the draft follow-up review report, PARD stated that they significantly increased the project oversight, with four review missions in 2019, as compared to a total of three review missions in the preceding years.

¹⁴ In the response to the draft follow-up review report, PARD indicated that PNRM staff met with the DoW BRIRAP team on 31 October 2019 to discuss this finding. PNRM clarified the position on the out-of-pocket expenses and the requirement for the consulting firm to return any unsubstantiated amounts. The Financial Manager of the project acknowledged the finding and agreed to seek supporting documents for all unsubstantiated out-of-pocket expenses claimed.

necessary, PNRM should initiate suspension of payments until DoW obtains ADB's approval and executes the contract amendments.

Procurement

24. **Check contract for consistency and ensure unambiguous interpretation of contractual provisions.** In the 2016 PPRR, OAI noted that one of the consultancy contracts contained inconsistencies, due to inaccuracies in calculations across different sections of the contract. Also, clauses on the basis of payment of out-of-pocket expenses (lumpsum or at-cost) were misinterpreted by the consultant. The PIU did not take action to ensure consistency in the provisions affecting payments to consultants before the contracts were signed. Further, the PIU did not take action to enforce contract provisions, nor amend the contract to reflect the real basis of payment of expenses. OAI reiterates its recommendation to thoroughly review the contract provisions before signing, to eliminate inconsistencies and potential areas of misinterpretation. During the follow-up review the PIU indicated that for future consultancy contracts, the specific clauses regarding out-of-pocket expenses will be discussed and agreed with the consultant during contract negotiations.¹⁵

Capacity

25. **Enhance the PIU's financial management capacity.** The PIU hired a financial management accountant and stated that they sent the senior accountant for overseas training. However, the quality of claims review did not improve, as the PIU continued to send claims without adequate supporting documents to ADB for processing. The PIU did not provide the attendance certificate for the senior accountant's overseas training.

26. The lack of financial management capacity in the PIU resulted in payment issues as reported in the 2016 PPRR and as confirmed in the follow-up review. OAI reiterates its recommendation to strengthen the PIU's capacity by identifying and assessing training needs and organizing targeted training sessions. OAI further recommends that PNRM requests and examines sample documents supporting payment claims to ensure eligibility of disbursements.

Recommendations excluded from the follow-up review scope

27. The follow-up review could not assess the implementation of the following PPRR recommendations because of the lack of review samples.

- (i) The DoW should involve at least one person with financial expertise as a member of the TEC to ensure due evaluation of financial qualification criteria of bidders/consultants.
- (ii) The PIU should prepare accurate and complete Invitation for Bids and bidding documents to enable prospective bidders to submit responsive bids. The PIU should ensure that the bidding documents are carefully reviewed and approved.
- (iii) The DoW/PIU should issue addenda to clarify bidding documents, communicate changes to all prospective bidders simultaneously, keep records of changes and communications.
- (iv) The DoW, through the BEC, should improve the evaluation process so that qualified contractors are selected to implement the contract.

¹⁵ In the response to the draft follow-up review report, PARD and PPFDF indicated that ADB conducted a training in PNG on project procurement in August 2019 where contractual arrangements for consulting contracts were discussed.

- (v) The PIU should closely monitor the civil works contract implementation to ensure completion as scheduled. The PIU should monitor the performance of contractors, consultants and DoW's engineers.

28. PIU representatives attended training sessions on procurement organized by PNRM in August 2017 and in March 2018. These covered, among others, the ADB Procurement Policy, bid preparation, bid evaluation, and report preparation. However, due to the lack of review samples, OAI did not observe evidence of procurement process improvements.¹⁶

29. ADB's Procurement, Portfolio and Financial Management Department (PPFD) outposted a Procurement Specialist to PNRM from mid-April 2018 to assist PNRM in supervising different executing agencies in their procurement activities. With the Procurement Specialist's support, PNRM needs to sustainably support and guide DoW and other executing agencies.

30. During the follow-up review, the PIU developed action plans for procurement-specific recommendations with assistance from OAI. PIU representatives and other DoW personnel implementing similar projects, participated in the action planning sessions. OAI recommends that DoW, with PNRM's support, oversees the implementation of these action plans. OAI also recommends that PARD and PNRM assess the implementation of the action plans during the review missions.

New Observations from the Follow-up Review

31. During the follow-up review, OAI made new observations relating to the project's financial management and asset management.

32. **Overpayment to contractor by ADB due to irregularities in IPCs.** In one of the civil works contracts, ADB paid PGK 1,241,627 (equivalent to USD 381,800) in excess of the amount due. This happened due to the contractor's overstated claim in one of the IPCs, which supervision consultant and the DoW endorsed for payment. Although the excessively claimed amount was corrected in a subsequent IPC, the excess amount already paid by ADB was not recovered from subsequent payments to the contractor. The recovery of PGK 1,241,627 is impossible and is considered project loss because the DoW and the contractor terminated the contract and released each other from any subsequent claims.

33. The overpayment resulted from lack of financial control by the PIU and the supervision consultant. Hence, DoW, with support from PARD and PNRM, should enhance the financial management function at the PIU through: (a) introduction of a procedure of thorough review of IPCs before their endorsement for payment, and (b) targeted trainings of existing staff or hiring new staff with strong financial management experience. PNRM should review and endorse withdrawal applications for projects involving DoW before their payment. This should be done through implementation of stringent review procedures and completion of detailed monitoring records of payments under each contract. PNRM's reviews should continue until such time the review results indicate satisfactory improvements in the financial management capabilities at DoW.

¹⁶ In the response to the draft follow-up review report PARD and PPFD indicated that ADB organized another procurement training in August 2019.

34. **No approval from ADB on variations exceeding 15% of contract price.** In one of the civil works contracts,¹⁷ the total amount of variations certified by the supervising consultant in IPCs and paid to the contractor, comprised 17.56% of the original contract price.¹⁸ The DoW did not seek ADB's approval for the variations, as required by ADB's Procurement Guidelines.¹⁹ Moreover, the DoW did not obtain the approval of the Central Supply and Tenders Board (CSTB) and National Executive Council (NEC), as required by contract for variations over 10% of the accepted contract price.²⁰

35. The DoW should timely submit to ADB all variation orders and contract amendments for ADB-financed projects. Whenever the cumulative effect of the variations exceeds 15% of the original contract price, DoW should seek ADB's prior approval for the variation orders.

36. For projects with DoW, PNRM should review the withdrawal applications to identify any variation orders that DoW did not submit to ADB. PNRM should request missing variation orders from DoW and assess whether the variations are reasonable. If the cumulative effect of variations exceeds 15% of the original contract price, PNRM should advise Controller's Department to pay the variation amount only after ADB approval of the variation order.

37. **Inappropriate handover of materials on site upon contract termination.** One of the civil works contracts was terminated in August 2017 by mutual agreement of DoW and the contractor. Upon contract termination, the contractor handed over to DoW materials on site valued at PGK 13,135,215 (equivalent to USD 4,039,078). The DoW did not conduct a full inventory of materials on site during the contract termination. The deed of termination and release contains only a partial list of materials handed over by the contractor and valued at PGK 3,262,758 (equivalent to USD 1,003,298). These were materials for which DoW had not paid the contractor but committed to pay after the termination. For the remaining part of the materials on site, that amounted to PGK 9,872,457 (equivalent to USD 3,035,780) and were paid through IPCs, the PIU did not provide the OAI's review team with any evidence of the handover upon contract termination.²¹

38. The above deficiencies in handover of materials represent significant risk of project losses due to the lack of inventory control. Thus, the PIU should thoroughly review the IPCs submitted by the new contractor hired to complete the civil works, to eliminate any mistakes arising from improper handover of materials upon termination of the initial contract and to avoid duplication of payments.

¹⁷ At the time of the follow-up review fieldwork, the procurement of a new contractor to complete the civil works was ongoing.

¹⁸ The total amount of variations was PGK 13,486,925.58 (excluding GST), which was 17.56% of the original contract price of PGK 76,795,062.47 (excluding GST).

¹⁹ ADB's Procurement Guidelines, Appendix 1 – ADB Review of Procurement Decisions, Clause 3 – Modifications requires: "In the case of contracts subject to prior review, before ... agreeing to any modification ... of such contract, including issuing any change order or orders under such contract (except in cases of extreme urgency) which would in aggregate increase the original amount of the contract by more than 15% of the original price, the borrower shall seek ADB's no objection to the proposed ... modification, or change order."

²⁰ Particular Conditions of Contract Clause 3.1 (B)(ii) requires: "All the variations up to 10% of the Accepted Contract Price must be approved by the Employer before the Engineer issues approval. Over and above 10%, the approval must be obtained from CSTB and NEC."

²¹ As of the latest certified IPC, the status of these was "Materials on Site".

Overall recommendations

39. Given the significance of the PPRR recommendations that were not implemented or partially implemented, and considering the additional observations made during the follow-up review, OAI strongly recommends PARD's and PNRM's closer supervision over DoW's and PIU's procurement, financial management and contract implementation processes.²² In particular, PARD should closely review the disbursements until such time that the DoW effectively implements the 2016 PPRR and 2018 follow-up review recommendations.

40. In addition, OAI reiterates its 2016 PPRR recommendations, as follows:

- (i) PARD and PNRM to
 - (a) formulate by June 2020 and consistently implement a targeted capacity development plan for the DoW and the PIU in financial management, procurement, and project supervision;
 - (b) conduct frequent review missions with the involvement of procurement and financial management specialists, and include in the scope the review of implementation of the action plans and pending PPRR recommendations;²³ and
 - (c) collaborate with PPF and Controller's Department to organize focused training sessions;
- (ii) PARD to review ineligible/unsupported payments to the supervision consultants and take measures for funds recovery;²⁴ and
- (iii) DoW to strengthen the financial management systems and internal controls across all levels and throughout project implementation.

41. Although contract management is the main responsibility of the construction supervision consultants, DoW and PNRM need to be more diligent during contract implementation. The capacity of the construction supervision consultants needs to be significantly strengthened, and their approved payment certificates need to be thoroughly reviewed before the payment.

42. Furthermore, the contract management capacity of the PIU remains weak. The interpretation of contract conditions is incorrect and tends to favor the contractor or consultant. Variation orders are not processed in accordance with contract conditions but are endorsed by PIU for payment. This increases the risk of integrity violations due to the lack of accountability and control.

43. DoW needs stringent controls in financial management processes. Deviations from the provisions of contracts should be disallowed. All justified variations during contract implementation should be reflected in contracts through amendments. Also, DoW should timely submit the variation orders and contract amendments to PNRM. Whenever required, prior to endorsement of variation orders, DoW should seek no objection from ADB, and relevant approvals from CSTB and NEC.

44. OAI recommends that the PIU and PNRM scrutinize payment requests submitted by contractors to ensure only eligible claims are paid. All IPCs submitted by the new contractor for

²² In the response to the draft follow-up review report, PARD informed that after OAI's fieldwork in May 2018, ADB hired a financial management specialist at PNRM, to support DoW in strengthening their financial management controls.

²³ Please refer to footnote 13

²⁴ Please refer to footnote 14

the terminated contract should be thoroughly reviewed to eliminate any potential mistakes arising from improper handover of materials upon the termination of the initial contract. PNRM is advised to call in, on a sample basis, documents supporting payment claims for closer review of eligibility of disbursements.

45. The outposting of an ADB procurement expert to PNRM is an important step to improve bidding documents and ensure more transparent selection of consultants and contractors, but it may not improve contract management. PARD and PNRM are recommended to ensure that quality of contract management improves through: (i) hands-on capacity building; (ii) assigning ADB consultants to DoW and PIU; (iii) outposting qualified international staff to PNRM to administer ADB projects at DoW; and/or (iv) administer the projects at ADB headquarters.

46. OAI is pleased to learn that ADB is in the process of approving a project preparatory facility, which among others aims at improving the capacity of DoW and the implementing units in the future transport sector projects in PNG. This is welcome news, indicating the willingness of PARD, PNRM and DoW to take a systemic approach in tackling the procurement, financial management and contract management issues identified in OAI's PPRRs.

III. ACKNOWLEDGEMENTS

47. OAI acknowledges the PIU and PNRM for their cooperation and responsiveness throughout the follow-up review. OAI is available for consultation on any matter in this report.