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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

FIDUCIARY SYSTEMS ASSESSMENT

ON

PROPOSED LOANS

IN THE TOTAL AMOUNT OF US\$400 MILLION EQUIVELANT

TO THE

PEOPLE'S REPUBLIC OF CHINA

FOR A

YANGTZE RIVER PROTECTION AND ECOLOGICAL RESTORATION PROGRAM

P171644

Negotiations Draft - Not for Circulation

November 2021

Water Global Practice

East Asia And Pacific Region

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FIDUCIARY SYSTEMS ASSESSMENT

YANGTZE RIVER PROTECTION AND ECOLOGICAL RESTORATION

PROGRAM FOR RESULTS

(P171644)

November 2021

The World Bank

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## ABBREVIATIONS AND ACRONYMS

BEC	Bid Evaluation Committee
CEM	Comprehensive Evaluation Method
CIIA	China Institute of Internal Audit
CNAO	China National Audit Office
CNY	Chinese Yuan (Renminbi)
DLI	Disbursement-linked indicator
DPO	Development Policy Operation
DRC	Development and Reform Commission
FM	Financial Management
FSA	Fiduciary Systems Assessment
FY	Fiscal Year
GPL	Government Procurement Law
INT	Vice Presidency Integrity Department
IPSAS	International Public Sector Accounting Standards
MOF	Ministry of Finance
NDRC	National Development and Reform Commission
OPRC	Operational Procurement Review Committee
PAO	Provincial Audit Office
PforR	Program for Results
PAP	Program Action Plan
PFM	Public Financial Management
PIA	Program Implementing Agency

PRC	People's Republic of China
PDRC	Provincial Development and Reform Commission
PFD	Provincial Finance Department
TBL	Tendering and Bidding Law
TOR	Terms of Reference
TSA	Treasury Single Account

## **SECTION 1: CONCLUSIONS**

### **1.1 Reasonable assurance**

Jiangxi and Hunan Provinces as well as central government (the TA component financed by IPF), together with the World Bank, are in the process of preparing the Yangtze River Revitalization Program-for-Results (PforR) Project. As part of preparing this operation, and pursuant to the World Bank's Policy and its associated Directive on PforR Financing of November 10, 2017 and June 20, 2019, respectively, as well as the World Bank's PforR Fiduciary Systems Assessment Guidance Note issued on June 30, 2017, and OP/BP 10.00 and the Financial Management Practice Manual for IPF, the World Bank's Fiduciary Team has carried out a fiduciary systems assessment (FSA). According to the FSA - and given the agreed actions to strengthen the fiduciary systems, as reflected in the DLIs, Program Action Plan (PAP), and other proposed mitigation measures will be implemented - the Program's fiduciary systems, including the financial management (FM), procurement, and governance systems, are considered to adequately meet the requirements laid out in the Bank's PforR Policy and Directive: They provide reasonable assurance that the Program's financing proceeds will be used for the intended purposes, with due attention to the principles of economy, efficiency, effectiveness, transparency, and accountability.

### **1.2 Risk assessment**

Major FM risks identified in the FSA are: 1) The financing sources of the program is quite comprehensive as it integrates funds from very broad sources and some of them are one time compensation funds; 2) Budget quota was distributed to counties/cities in batches and some program funds were delivered in the second half year or even the year end which prevents the county government from including the entire program funds in its annual budget and delays the implementation of planned activities; 3) 'Program' is not a budget classification element in China and the required Program financial reporting can't be generated from government treasury system; 4) No requirement by provincial government on reporting of program

expenditures in Hunan province and the reporting requirement stipulated in government decrees were not strictly implemented in Jiangxi province; 5) Absence of efficient supervision by related provincial entities on the usage of program funds may bring potential risk of improper use of program funds; and 6) Government auditors did not audit the program funds and prepare the program audit report.

The proposed mitigation measures include: 1) Multiple-year program budgeting should be prepared to ensure program funds could be secured and county government could prioritize its investment to enhance the efficiency of its scarce financing resources; 2) Provincial entities should revisit their budget quota distribution and take actions to ensure the budget quota could be distributed to county/city in advance; 3) A blue tagging mechanism which can trace program expenditures from government existing integrated financial management system has been recommended and it is expected to be piloted, especially in those demonstration counties, during project implementation. This also creates fundamental basis for generating program financial reporting from government treasury system; 4) A tailored program financial reporting template will be designed which can capture the data from government system and used by the project upon agreed by related government entities; 5) The decrees about program expenditure supervision should be established in Hunan province. Provincial entities involved should strengthen the supervision on program funds in line with related government decrees; and 6) The Bank will work with the Provincial Audit Offices (PAO) to develop the terms of reference (TOR) for program auditing to ensure program funds could be audited in line with the Bank's policy.

Major procurement risks identified are: 1) Contracts may be awarded to firms or individuals which are debarred or under temporary suspension by the Bank or other multilateral development banks; 2) The Bank may not be informed of fraud allegations and corruption issues during the implementation of the Program. 3) In Jiangxi the most common procurement method for works in the construction sector is the Price Commitment Method, it is questionable as to whether it offers value for money as the price is predetermined

and bidders can't offer a lower price; 4) Contracts may not be completed within the contractual completion time, and the contract completion audit may not be completed timely.

The following mitigation measures have been proposed: 1) Upon Program loan effectiveness, the Hunan and Jiangxi Province Development Reform Commission (PDRC) shall issue a high-level official letter or official instruction to require Program implementation agencies to ensure that no contract will be awarded to ineligible firms or individuals; 2) Procurement staff at the Hunan and Jiangxi PMO are to check before contract award the latest lists of the debarred and temporarily suspended firms and individuals to ensure contract being awarded to eligible firm or individual; 3) The TOR for annual external audit shall include the task of randomly selecting contracts and assessing whether they have been awarded to an ineligible firm or individual; (4) A Program Implementation Plan shall be prepared by the PDRCs and they are required to inform the Bank of any credible and material allegations of fraud and any corruption issues as part of the Program Progress Reports, as mandated in the loan agreement; 5) For value for money to be achieved it is critical that the cost estimating process is robust and that unit prices are regularly updated to ensure the cost estimate is as accurate as possible; 6) Procedures or a guidance note should be produced by Hunan and Jiangxi Provincial Development Reform Commission that clearly define the undertaking of contract administration responsibilities in line with the Regulatory Framework of the agencies.

Taking into consideration the above-mentioned FM and procurement risks and the proposed mitigation measures, the overall fiduciary risk of the Program is rated as 'Substantial'.

### 1.3 Procurement exclusions

Under the Program, no high value contracts will be awarded exceeding the Bank's Operational Procurement Review Committee (OPRC) thresholds<sup>1</sup>.

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<sup>1</sup> OPRC thresholds for substantial risk projects are USD 75 million for works, USD 50 million for goods, information technology and non-consulting services, and USD 20 million for firm consultants.

## SECTION 2: SCOPE

There is no difference between government program and the program financed by the Bank regarding geographic boundary and it is covering all counties (about 100 counties in each province) of the sub-national programs in Jiangxi (River Basin Eco-Compensation Mechanism for the “5-Rivers-1-Lake” Plan) and Hunan (Integrated Water Environment Management Plan for Dongting Lake Basin). The fiduciary team has assessed the fiduciary systems of all key Program implementing agencies in Jiangxi and Hunan Provinces, including the provincial Finance Department, Development and Reform Commission, Department of Environment and Ecology (DEE), Department of Water Resources (DWR), Department of Agriculture and Rural Affairs(DARA), Provincial Audit Office and related line bureaus in several selected counties. The team also assessed the capacity of central PMO and agreed on the fiduciary arrangement for TA component (related fiduciary arrangements are presented in a separate annex of PAD).

The FSA of the procurement system covers the implementation agencies responsible for carrying out major program procurement and contract implementation, as listed in below Table 1.

Table 1 - Procurement implementation agencies

Province/County	Implementation agency
<b>Hunan</b>	
Yuanling county, Shimen county, Miluo city, Wangcheng district and Ziyang district	Water Resource Bureau
	Housing and Construction Bureau
	Agriculture and Rural Affairs Bureau
<b>Jiangxi</b>	
Chongyi, Dayu, Yudu, Yongfeng, Yugan and Fuliang county	Water Resource Bureau
	Housing and Construction Bureau

## **SECTION 3: REVIEW OF THE PFM CYCLE**

### 3.1 Planning and budgeting

#### 3.1.1 Adequacy of budgets

The Budget Law of the People's Republic of China (PRC), issued in 2015 and revised in 2018, has set the budget management framework for the central government and local governments at all levels in China. The financial budget includes four budgets, and there are detailed provisions for the preparation, review, approval, supervision, implementation, and adjustment of the budget and final accounts. The provincial Finance Department and county finance bureaus are responsible for preparing the annual budget and final accounts at the corresponding level, for organizing the implementation of the general budget, deciding on the use of the budget reserve, working out budget adjustment plans, supervising budget execution of the budget implementing entities, and for reporting to the People's Congress and its Standing Committee on the implementation of the annual budget.

The bottom-up preparation method and the process of 'two ups and two downs' are adopted when preparing the budget. The 'first up' refers to the budget proposals prepared by the budgetary units and submitted to the respective finance department/bureau. The 'first down' refers to the finance department/bureau's release of the budget ceilings for each budgetary unit upon review of the submitted proposals. For the 'second up', each budgetary unit revises its budget proposal in line with the received budget ceiling and re-submits it to the finance department/bureau. The 'second down' means the approved sectoral budget is distributed to each budgetary unit once the annual budget prepared by the finance department/bureau has been approved by the People's Congress.

Jiangxi Province integrated fiscal transfers from the central government, budgetary funds from local governments and the market, and established Jiangxi’s River Basin Ecological Compensation Fund since 2016. Total funds integrated in the 13<sup>th</sup> five-year plan is around RMB 14 billion. The scale of compensation fund has grown substantially from 2016 to 2018, by about 49.45 percent. The total amount of funds raised in 2019 was roughly the same as that in 2018, reaching RMB 3.118 billion. However, the composition of the fund is various from year to year. It is noted the proportion of central special transfer payments in 2016 was slightly higher than that of the provincial self-raised funds, but the proportion of provincial self-raised funds accounted for more than twice the proportion of central special transfer payments in 2017 and 2018. In 2019, the situation has completely reversed, and the proportion of central special transfer payments exceeded 85 percent (details refer to the table below). The estimate figures for 2020 is bit different from previous years (for details refer to the table below). The irregular fluctuation of the total investment each year and composition of the fund bring uncertainties on predicting the reliability of the program fund.

Table 2- Financing sources of government program

	2016	2017	2018	2019	2020 (Estimated value)
Total Funding (million yuan)	2,091.00	2,690.00	3,125.00	3,118.00	2,756.00
Central government investment (million yuan)	1,091.00	599	834	2,695.44	1,304.86
Proportion of central government investment (%)	52.18	22.27	26.69	86.45	46.89

Local government (province, city, county and district) investment (million yuan)	1,000.00	2,091.00	2,291.00	422.6	1,451.15
Proportion of investment by local governments (province, city, county and district) (%)	47.82	77.73	73.31	13.55	53.11

The budget quota of compensation fund is distributed to city/county government in two tranches. The first tranche which mainly comes from central government transfers is distributed in advance at the end of the previous year, and the second one mainly from provincial government is normally delivered in the second half of the current year (details refer to the table below). The city/county government used to integrate the first tranche in their annual government budget, but the treatment of the second tranche is various. Some counties included the second tranche in their annual budget based on the projection and made adjustment later on, while others just waited the distribution of budget quota. As the result, the activities had to be postponed to the next year since the quota was normally received quite late. The lack of predictability of the second tranche hampers the capacity of local governments to forecast cash or credibly allocate budgets to budgetary units.

Table 3- Distribution of budget quota from 2016 to 2019 for Jiangxi province

year	Total program budget (million yuan)	Amount delivered in advance for the next year (million yuan)	(%)	Amount delivered in current year (million yuan)	(%)
2016	2091	1017.2	48.65	1073.8	51.35

2017	2742	1447	52.77	1295	47.23
2018	3177	1662	52.31	1515	47.69
2019	1200	0	0	1200	100

The funds to be invested in the proposed Program would stem from various funding sources, including transfer funds from the central and provincial governments, as well as funds from the respective county government’s budget. The Fiduciary Team observed gaps between the funds available and funds to be invested due to the weak capacity of some county governments in raising counterpart funds. Although the compensation funds allocated to each county (cities, districts) has a significant negative correlation with its economic development level or the level of local government financial resources, say less developed counties/cities get more compensation, the self-reporting from county/city shows most of them stated that they were under the pressure to raise the financial sources on environmental protection related matter and expected that more component funds could be distributed from upper level government.

According to the "Jiangxi Province River Basin Ecological Compensation Methods" issued in 2018, it is stipulated that the compensation funds should be mainly used for ecological protection, water environment management, forest quality improvement, forest resource protection, water conservation and protection, ecological poverty alleviation, and improvement of people’s livelihood. However, budget tagging is not adopted in China and it is a challenge identify the final usage of the compensation. Based on county’s self-reporting for the year 2018, the top three areas supported by the compensation include: water environment improvement and water resource management accounted (30.89%), ecological protection (37.59%), forest protection and improvement accounted (17.86%).

In Hunan province a program called “Dongting Lake Water Environment Comprehensive Treatment Program” has been approved by the State Council with total estimated budget of RMB 59.18 billion covering the period

from 2018-2025. However, program budget was not prepared, and no clear funding sources were identified for each program activity. Instead, sectoral departments were required to integrate various available financing sources (refer to the expected funding sources table below).

Table 4 - Expected funding sources

Unit: RMB 100 million

Provincial entity	2017		2018		2019	
	Expected funds from central government	Expected funds from provincial government	Expected funds from central government	Expected funds from provincial government	Expected funds from central government	Expected funds from provincial government
PDRC	6.3	1.2	7.2	1.4	11	1.9
Department of Ecology and Environment	5.6	-	8.2	-	9.7	-
DARA	-	-	0.1	-	-	0.2
Department of housing	-	3.2	1.8	4.3	11.4	6.3
Department of Water Resources	0.7	5.2	2.1	7.5	1.1	3.8
Department of Forestry	-	-	4.5	0.1	4.5	0.9
Total	12.6	9.6	23.9	13.3	37.7	13.1

From 2018 to 2020, central government and Hunan provincial government allocated about RMB 25 billion on water-environmental management in the Dongting Lake Basin from primarily 13 funding sources: Wastewater and Waste (including sludge management), Ecological Restoration, Rural Environment (including toilet

revolution), Rural non-point source pollution, Rural environment (including rural wastewater), Water pollution control and reduction, Wetland Protection, Livestock and Poultry Breeding Pollution Management, Organic Fertilizer Piloting, Dongting Lake Water Environment, Aquaculture and animal waste management, Key Ecological Function Zone Transfer, Environment Management Capacity. It is noted that some of these funding sources are one time compensation and only available in a year.

In addition, some of the upper level transferring funds are distributed to counties in the form of general budget rather than ear-marked budget, and counties are playing essential roles in deciding how to use the program funds although central and provincial government set up the requirement on minimized percentage of using transferring funds on program activities.

In both provinces, it is noted county governments neither prepare medium-term budgets, nor do they link budgets to the prevailing development strategies or provide any explanation about the fiscal implications of policy changes. Since the budget quota was distributed to counties in tranches and sometimes the quota was delivered quite late, it is hard for counties to include all program funds in their annual budget.

In light of the above issues, the Bank is concerned about the predictability and reliability of funds for the proposed Program. Therefore, to address this weakness the Bank recommended that a multiple year program budgeting should be established in the provinces to ensure program financing sources are reliable and predicable. This would moreover support the Government in moving towards program-based PFM, including program-based financial reporting. Since this is an innovation in China, to minimize the impact on the existing government budgeting system, the multiple year program budgeting could be prepared separately from the existing system. Provincial finance departments agreed that they would prepare the provincial level multiple years program budget as it is impossible for them to provide detailed allocation to each county. Program county could use this budget as reference when preparing their own budget.

### 3.1.2 Procurement planning

The responsible implementation agency prepares the procurement plan based on the available allocated budget and/or according to the available self-raised funds. The procurement plan is submitted to the respective supervision authority and the finance department/bureau for review and clearance. Since the procurement plan is prepared by the implementation agency, which is the end-owner of the works, goods, and services to be procured, the plan is closely linked to its needs. During the FSA, the 11 selected Program counties (5 in Hunan and 6 in Jiangxi) were required to provide information on actual contract volumes awarded compared to the original cost estimates. The provided data are as follows:

Table 5 - Actual award price against cost estimate

Province/ County	Implementation agency	Actual award price against cost estimate (%)		
		Works	Goods	Services
<b>Hunan</b>				
Yuanling	Water Resource Bureau	80	/	/
	Housing and Construction Bureau	95	95	98
	Agriculture and Rural Affairs Bureau	/	/	98
Miluo	Water Resource Bureau	92	/	/
	Housing and Construction Bureau	89	90	75
	Agriculture and Rural Affairs Bureau	90	93	95
Wangcheng	Water Resource Bureau	95	95	98
	Housing and Construction Bureau	90	90	90
	Agriculture and Rural Affairs Bureau	93	/	/
Ziyang	Water Resource Bureau	99	95	98

	Housing and Construction Bureau	92.5	92.5	92.5
	Agriculture and Rural Affairs Bureau	98.6	/	99
Shimen	Water Resource Bureau	95	95	95
	Housing and Construction Bureau	99	96	/
	Agriculture and Rural Affairs Bureau	94	97	92
<b>Jiangxi</b>				
Chongyi	Water Resource Bureau	96	/	96.6
	Housing and Construction Bureau	94	95	/
	Agriculture and Rural Affairs Bureau	90	90	90
Dayu	Water Resource Bureau	96	/	/
	Housing and Construction Bureau	93.8	/	/
	Agriculture and Rural Affairs Bureau	90	/	/
Yudu	Water Resource Bureau	no data	/	100
	Housing and Construction Bureau	92	85	100
	Agriculture and Rural Affairs Bureau	/	96.5	100
Yongfeng	Water Resource Bureau	96.5	/	/
	Housing and Construction Bureau	100	/	100
	Agriculture and Rural Affairs Bureau	/	/	100
Yugan	Water Resource Bureau	98.9	99	100
	Housing and Construction Bureau	100	/	/
	Agriculture and Rural Affairs Bureau	95	98	96
Fuliang	Water Resource Bureau	96	/	94
	Housing and Construction Bureau	94	/	/

	Agriculture and Rural Affairs Bureau	93	/	80
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### 3.1.3 Procurement profile of the Program

Procurement activities under the Program will include the procurement of (i) Construction of county and township WWTPs; Upgrading and expansion of county and township WWTPs and Construction and rehabilitation of sewer networks; Construction of manure treatment facilities in livestock and poultry farms; Construction of large and medium sized biogas facilities in centralized breeding communities; Construction of manure collection and recycling facilities for small scattered farmers and organic fertilizer processing plants; (ii) Goods and services related to wastewater treatment equipment, wastewater pipelines, wastewater pumps; Establishment or improvement of river chief system information platform, data & information management system; Promoting organic fertilizer substitution; Solid waste removal (mainly including plastic waste) from river channels; institutional strengthening and capacity building. The Program related provincial level policies and guidelines will be developed by relevant provincial level government agencies.

## 3.2 Budget execution

### 3.2.1 Treasury management and funds flow

Per the county's self-reporting in 45 counties of Jiangxi province, the average utilization rate of the program funds was 90.67% in the past three years. However, as reported by provincial water resources department, the actual investment on water resources management during the 13<sup>th</sup> five-year plan is about RMB 114.7 billion which is 79.2% of the program budget, some activities are not completed as planned. Government officials need to pay more attention on the budget execution to ensure the budgeted investment can be implemented as planned.

According to the self-review reports, the modes of fund use can be categorized into three types: earmarked funds for exclusive use, blended use with other financial sources, unreported and unused. Table below shows the expenditure modality of RBCEP in various counties (cities, districts). It can be seen that most local governments (accounting for 64.95 percent) use the RBCEP as earmarked funds, and a small proportion of local governments (accounting for 27.84 percent) blended the RBCEP with other financial sources at the county level. Five counties (cities, districts) have not reported the specific usage of the RBCEP. Two counties (cities, districts) have not used the RBCEP in the current year.

*Modes of RBCEP spending by counties/districts*

Mode	Number of counties/districts	Proportion (%)
Earmarked Funds	63	64.95
Blended with other financial sources	27	27.84
Unused	2	2.06
Unreported	5	5.15
Total	97	100

Data source: Department of Finance of Jiangxi Province

Through analyzing the final accounts in Hunan province for the past three years it is noted that Hunan used about RMB 24.34 billion on water environmental management from the year 2018 to 2020 (refer to the table below), roughly matching the total allocated budget, indicating program activities were mostly implemented as planned.

Table 6 - Final expenditure on water-environment management in Hunan 2018-2020 (RMB billion)

Item		2018	2019	2020	Total	Percent
2110302	Water pollution prevention and Treatment	2.94	4.20	4.48	11.62	47.73
2110401	Ecological protection	0.41	0.77	0.62	1.80	7.41
2110402	Rural environment management	1.72	2.39	1.87	5.98	24.58

2111191	Ecological and environment monitoring and information	0.13	0.53	0.26	0.92	3.99
2111102	Ecological and environmental supervision and law enforcement	0.03	0.02	0.02	0.07	0.28
2130205	Forest conservation and cultivation	1.21	0.96	0.72	2.88	11.84
2130212	Wetland protection	0.20	0.18	0.11	0.49	2.02
2130310	Water and soil conservation	0.20	0.21	0.17	0.58	2.38
Total		6.83	9.27	8.24	24.34	

Governments at all levels have integrated all financial funds into the treasury single account (TSA) system. All revenues are directly collected into the treasury account or the special financial account, and all expenditures are paid to the contractors/suppliers/beneficiaries through the TSA.

County governments effectively strengthen fund supervision and ensure the standard and efficient use of funds by strictly following the basic requirements of special funds, centralized payment by the national treasury, public bidding, and government procurement. The county finance bureaus allocate funds based on relevant materials such as the acceptance and settlement statement prepared by project supervisory entity, project unit, county auditing bureau and county finance bureau.

Related regulations have been established in some counties to standardize the appropriation principle, appropriation conditions, appropriation process and account review procedures to ensure the fund appropriation system is implemented within a time limit, and the funds are allocated to the user unit in a timely manner, which improved the use of funds and ensured the safety of fund operations.

Payments can be made to the budgetary units within the approved budget. The centralized payment center at each county finance bureau is responsible for initiating all payments, following the request of the budgetary units.

Since program is not a budget classification element, it is hard to trace the program expenditures from government existing treasury system. In Hunan province, the counties receiving program funds are not required to report program expenditures regularly to upper level government. In Jiangxi province, although government decree requires that county government report to PDRC and PFD about its program expenditures annually, such requirement has not been strictly implemented always. As a result, program expenditures are not properly monitored and managed at provincial level. In addition, some transferring funds are distributed in the form of general budget rather than ear-marked budget, absence of regular monitoring may dilute the efficient budget management. Therefore, a budget tagging (blue tagging) system is recommended by the Bank to ensure program expenditures can be traced and monitored properly. Based on the discussion with related government entities, it is noted that MOF also initiated a similar reforming plan to ensure the ear-marked expenditures can be traced and monitored properly. In addition, it is confirmed that the blue tagging is practicable from technical perspective. The detailed arrangement of the blue tagging needs to be further discussed with related government entities. It was agreed that the provinces will explore piloting “Blue Tagging Program” for program related expenditures in the Government treasury system. This would allow Program Financial Reports to be generated directly from the treasury system during project implementation, especially in the demonstration counties. Detailed arrangements will be prescribed in the Program Implementation Plan to be developed by the Provincial PMO. Provincial finance departments will decide when and how to implement this piloting by considering the readiness of government reform on the integrated financial management information system.

. As an alternative, a tailored program financial reporting template will be designed for the project before such innovation is completed.

### 3.2.2 Accounting and financial reporting

In 2013, the MOF initiated a piloting reform for accrual-basis government financial reporting. The provinces introduced accrual-basis financial reporting on a trial basis, but the reports were neither submitted to the People’s Congress for review and approval nor subject to the government auditors’ annual audit. In 2018, an accrual-basis accounting regulation was issued by the MOF for the public sector in China to provide a concrete basis for budget executing entities to record their transactions and prepare their financial reports on accrual basis. The new regulation, which adopts international good practice and principles of the International Public Sector Accounting Standards (IPSAS), became effective on January 1, 2019. The first accrual-basis government financial report is supposed to be prepared for FY 2019, however, the report has

not been submitted to the People’s Congress and auditors, since the related procedures and requirements are still under consultation and discussion.

For fixed assets owned and used by budgetary units, both physical and financial data are maintained in the selected counties. However, for infrastructure managed by the budgetary units, only physical, no financial information is held. According to the MOF’s newly issued government accounting regulation, from January 1, 2019 onwards, all fixed assets, including infrastructure, should be presented in the accrual-based reports. However, from discussions with related government entities it was noted that such requirement was not widely implemented across the whole provinces.

Since ‘program’ is not a budget classification element, program-based financial reports cannot be generated from the government treasury system. If the “blue tagging” innovation could be accepted by government authorities, the proposed program financial reporting would be generated from government treasury system. Otherwise, a tailored Program financial reporting template will be discussed and agreed on by the Bank and all government entities involved. Some budget items which are used to capture program expenditures have been identified and the template will be designed based on these items. The program financial report which is audited by the external auditors will be submitted to the Bank within 9 months after the end of each fiscal year.

### 3.2.3 Procurement processes and procedures

#### *3.2.3.1 Procurement regulatory framework*

Generally, the procurement of works, goods and material which is incorporated into permanent works, and consultancy services related to works, including geological exploring and survey, engineering design, cost estimating and pricing, and construction supervision follow the procedures specified in the Tendering and Bidding Law (TBL) and the related implementation regulations enacted by the governments at central, provincial, prefectural, and county level in accordance with the TBL. The TBL became effective as of January

1, 2000. At the central level, the implementing regulation came into force on February 1, 2012 and was amended on March 1, 2017, March 19, 2018, and March 2, 2019.

Other procurement follows the procedures stipulated by the Government Procurement Law (GPL) and the related implementing regulations promulgated by the governments at central, provincial, prefectural, and county level. The GPL became effective as of January 1, 2003. At central level, the implementing regulation for the GPL issued by the State Council became effective as of March 1, 2015.

### *3.2.3.2 Procurement processes and procedures*

#### **Procurement following the TBL**

The Development and Reform Commission (DRC) at central, provincial, prefectural, and county level provides overall guidance for, and coordination of all procurement activities which follow the TBL and its related implementing regulations. The relevant sectoral government authorities at the given level assume the day-to-day supervision responsibilities for the procurement activities.

The procurement methods allowed for by the TBL include open competitive bidding and direct invitation (limited competitive bidding or shopping), with open competitive bidding being the preferred method.

Public resources transaction centers exist at the provincial, prefectural levels in Hunan and at the provincial, prefectural and county levels in Jiangxi. They provide an electronic platform for their clients, the implementing agencies, to publish their procurement notices and to issue the bidding documents and any subsequent clarification and addenda. All bidders are required to register with the transaction centers' information system. They then submit bids and bid securities electronically. Bids are opened electronically. The transaction centers provide physical space for bid opening and evaluation, bid evaluation committee members evaluate bids in the monitored room in transaction center. Together with staff from the relevant sectoral government authorities, the staff of the transaction centers assume the supervision and monitoring functions during the bid opening and evaluation, but do not participate in the bid evaluation. The transaction centers also provide

a website for the publication of the contract award recommendation and, after the standstill period, of the final contract award.

In all provinces, it is common practice for qualified procurement agent companies to carry out procurement services on behalf of clients. These companies receive a special certification from the relevant government authorities.

If the value of the contract to be procured exceeds a specified threshold – that is,  $\geq$  CNY4 million for works,  $\geq$  CNY2 million for goods, and  $\geq$  CNY1 million for services - procurement needs to take place through open competitive bidding at the local public resources transaction center. If the value of the contract to be procured is less than the specified threshold, procurement can be carried out through limited competitive bidding or shopping, and the procurement is not mandatorily required to be conducted at the public resources transaction center. The invitation for limited competitive bidding or shopping is sent to at least three qualified bidders.

The procurement notice is published on the website of the Hunan Provincial Tendering and Bidding Supervision (<http://www.bidding.hunan.gov.cn>) and the relevant prefectural website of the public resources transaction (for example for Huaihua, the prefecture of Yuanling county, <http://ggzy.huaihua.gov.cn/>) as well as the website of Jiangxi Provincial Public Resources Transaction (<http://ggzy.jiangxi.gov.cn>) and relevant prefecture website of the public resource transaction (for example for Ji'an, the prefecture of Yongfeng county, <http://ggzy.jian.gov.cn>). It contains information of civil works, goods or services to be procured, including the information on the quantity of the works activities/goods/service assignments, the location, the requested completion/delivery time, the name, address, and contact of the client, the qualification and experience requirements of the bidder, etc.

The client is responsible for the preparation of the bidding documents, with assistance of the procurement agent company hired by the client (which normally helps with the commercial part of the bidding document),

the design institute (which normally helps with the technical part of the bidding document) and sometimes a professional firm (which usually helps with the bill of quantities). There are standard bidding documents issued by various line ministries and sectoral departments. In accordance with the TBL and relevant implementation regulations, the bidding document must not contain biased qualification, experience or technical requirements. Reference to specified manufacturers is also not allowed.

After publication of the procurement notice, potential bidders are given at least five calendar days to acquire the bidding documents.

Any request for clarification regarding the bidding document is required to be sent not later than ten calendar days prior to the deadline for bid submission and opening. The client is required to provide response to such requests for clarification within three calendar days. Any clarification or addendum shall be issued in writing to all the bidders not later than 15 days prior to the deadline for bid submission and opening (which needs to be extended if inadequate time left).

The time between the date of availability of the bidding document and the deadline for bid submission and opening is not less than 20 calendar days.

According to the TBL and its implementing regulations, if the number of bids received is less than three, re-bidding must be conducted.

All bids received by the deadline for bid submission and opening, and are properly sealed, are opened and read out. Any bid which is not properly sealed will be rejected, unopened, and not read out.

The amount of the bid security does not exceed two percent of the cost estimate, and not more than CNY0.8 million maximum. Validity of the bid security and validity of the bid are the same.

The bid evaluation methods used are outlined in the Tendering and Bidding Supervision Regulation and Qualification Method issued by the Hunan and Jiangxi Housing and Urban & Rural Development Department.

There are three main bid evaluation methods, the price commitment method, the lowest reasonable price

method and the comprehensive evaluation method which are used in Jiangxi and two main bid evaluation methods, the lowest reasonable price method and the comprehensive evaluation method are used in Hunan.

#### Price Commitment Method

In Jiangxi the most common procurement method is the Price Commitment Method as detailed in the Tendering and Bidding Supervision Regulation and Qualification Method and on average over 100 bids per procurement process are received. The Regulations state that the Price Commitment Method should only be used for procurements up to the value CNY50 million (US\$7.029 million) and for any contracts over CNY50 million the lowest reasonable price method should be used.

When the price commitment is used, the procuring entity or procurement agent determines the offer price according to the bidding control price of the contract which is determined by the cost estimate. This process is fully detailed in the Tendering and Bidding Supervision Regulations including formulas and the province uses two estimating software packages to determine the offer price. The offer prices must be equal to or less than the bidding control price. When a bidder submits a response to a procurement, the bidder makes a price commitment to the offer and bidders can't offer a different price than the offer price.

The Price Commitment Method displays the procurement principles of being open, fair and transparent but it is questionable as to whether it offers value for money as the price is predetermined and bidders can't offer a lower price. For value for money to be achieved it is critical that the cost estimating process is robust and that unit prices are regularly updated to ensure the cost estimate is as accurate as possible.

#### Lowest Reasonable Price Method

The Lowest Reasonable Price Method may be used for any procurement, which is a more traditional procurement method and similar to the Banks lowest evaluated compliant bid. The technical standard of the bidder is evaluated in line with the technical requirements of the project and the bid price is approved by the bid evaluation committee if it is recognized as reasonable, with the lowest bidder winning the contract.

## Comprehensive Evaluation Method

The Comprehensive Evaluation Method, known as CEM is applicable for special/large contracts. The CEM method helps to ensure that the contractor with the right experience and best technical proposal is selected by using rated criteria. The CEM requirements are a draft version of the management rules which have no mandatory requirements.

The bid evaluation committee (BEC) comprises five or seven members, one from the client and others selected randomly from official sectoral expert databases maintained by the relevant government authorities at the central or provincial level. The experts are normally required to have a working experience of not less than eight years in the relevant sector.

The contract is normally awarded to the most responsive/reasonable lowest responsive/highest scored responsive bidder that meets the qualification and experience requirements specified in the issued bidding documents.

The contract award recommendation is disclosed to the public including all the bidders, and the standstill period is at least three calendar days.

The contract award information is published on a specified website of the Hunan Provincial Tendering and Bidding Supervision (<http://www.bidding.hunan.gov.cn>) and the website of Jiangxi Provincial Public Resources Transaction (<http://www.jxsoggzy.gov.cn>). In addition, it is also published on the prefectural website of the public resources transaction center (for example for Huaihua, the prefecture of Yuanling county <http://ggzy.huaihua.gov.cn/> and Ji'an, the prefecture of Yongfeng county, <http://ggzy.jian.gov.cn>).

Within 30 calendar days after contract award, the client and the successful bidder sign the contract. The successful bidder will furnish to the client the performance security, if so required in the bidding document. The amount of performance security normally does not exceed ten percent of the contract price.

Within five calendar days of contract signing, the client will return the bid securities to the bidders including the saving interest amount accrued in the corresponding period.

### **Procurement following the GPL**

The MOF and the finance authorities at central, provincial, prefectural, and county levels provide overall guidance for, and coordination and supervision of, all procurement activities which follow the procedures of the GPL and its implementing regulations. The relevant sectoral government authorities assume the day-to-day supervision responsibilities for procurement activities.

If the value of the contract to be procured exceeds the specified threshold (normally CNY1 million), procurement shall be conducted through open competitive bidding at the local public resources transaction center. If the value of the contract to be procured is less than the specified threshold, the procurement can be carried out through limited competitive bidding or shopping. The procurement is not required to be conducted at the public resources transaction center.

The following procurement methods may be adopted under the GPL:

- Open competitive bidding (the preferred procurement method).
- Direct invitation.
- Competitive dialogue/Competitive negotiation
- Single source selection.
- Shopping.
- Other methods which may be approved by the relevant government authorities.

The procurement notice is published on the specified website of Hunan Provincial Government Procurement (<http://www.ccgp-hunan.gov.cn/>) and the website of Jiangxi Provincial Government Procurement (<http://www.ccgp-jiangxi.gov.cn/>). In addition, the procurement notice is also published on the relevant

prefectural website of the public resources transaction center (for example for Huaihua, <http://ggzy.huaihua.gov.cn/>, for Jian, <http://ggzy.jian.gov.cn>). The procurement notice contains information of civil works, goods or services to be procured, including information on the quantity of the works activities/goods/service assignments, the location, the required completion/delivery time, the name, address and contact of the client, the qualification and experience requirements, etc..

At least five calendar days are made available to the potential bidders to acquire the bidding documents.

Any clarification or addendum is issued in writing to all bidders not later than 15 days prior to the deadline for bid submission and opening.

The client is responsible for the preparation of the bidding document following the standard bidding documents issued by the MOF. The bidding documents should not contain biased qualification, experience or technical requirements. Reference to specified manufacturers is also not allowed.

The amount of bid security does not exceed two percent of the cost estimate.

With respect to the evaluation criteria, the GPL provides two options for bid evaluation: (a) contract award to the lowest responsive bidder; (b) contract award to the highest rated responsive bidder.

The BEC members are selected randomly from official expert databases for government procurement maintained by the relevant government authorities at the central or provincial level.

The contract award recommendation is disclosed on the website of Hunan Provincial Government Procurement (<http://www.ccgp-hunan.gov.cn/>) and the website of Jiangxi Provincial Government Procurement (<http://www.ccgp-jiangxi.gov.cn/>) within two working days after the contract award recommendation is made. In addition, the information is published on the relevant prefectural website of the public resources transaction center (for example for Huaihua, <http://ggzy.huaihua.gov.cn/>, for Jian, <http://ggzy.jian.gov.cn>). Recently the signed contract is also required to be disclosed on the relevant website.

If the number of qualified bidders or the number of responsive bids is less than three, re-bidding is required.

The bid security is returned to the unsuccessful bidders within five working days after contract award notification and to the successful bidder within five working days after contract signing.

**Procurement performance**

Procurement is generally efficient. The time from publication of the procurement notice to the deadline for bid submission and opening is normally 20 calendar days. The bid evaluation is usually completed in one day. Once the evaluation is completed, the contract award recommendation is disclosed to all bidders for three days on the official website of the government and the website of the public resources transaction center. If no complaint is received within the standstill period, the contract is awarded promptly and signed within 30 calendar days after contract award. In general, the bidding process is highly competitive. The data provided by the 11 selected Program counties show that there is adequate competition with a substantial number of participating bidders:

Table 7 - Number of participating bidders

Province/ County	Implementation agency	Number of participating bidders		
		Works	Goods	Services
<b>Hunan</b>				
Yuanling	Water Resource Bureau	13-16	/	4-8
	Housing and Construction Bureau	3-21	3-6	3-6
	Agriculture and Rural Affairs Bureau	/	/	3-6
Miluo	Water Resource Bureau	4-39	/	/
	Housing and Construction Bureau	3-11	/	/
	Agriculture and Rural Affairs Bureau	503	16	32

Wangcheng	Water Resource Bureau	10-35	3-8	3-5
	Housing and Construction Bureau	3-10	3-10	3-10
	Agriculture and Rural Affairs Bureau	9-40	/	/
Ziyang	Water Resource Bureau	7	4	4
	Housing and Construction Bureau	3	3	3
	Agriculture and Rural Affairs Bureau	84	/	15
Shimen	Water Resource Bureau	4	3	3
	Housing and Construction Bureau	3-5	3-5	1
	Agriculture and Rural Affairs Bureau	70-129	3-5	3-5
<b>Jiangxi</b>				
Chongyi	Water Resource Bureau	50-70	/	5-10
	Housing and Construction Bureau	3-25	3-5	/
	Agriculture and Rural Affairs Bureau	3-5	3-10	3-10
Dayu	Water Resource Bureau	50	/	/
	Housing and Construction Bureau	EPC 5 20-500	/	/
	Agriculture and Rural Affairs Bureau	90-110	/	70-80
Yudu	Water Resource Bureau			
	Housing and Construction Bureau	30	no data	142
	Agriculture and Rural Affairs Bureau	/	45	110
Yongfeng	Water Resource Bureau	100-200	/	/
	Housing and Construction Bureau	70-700	/	3-10
	Agriculture and Rural Affairs Bureau	/	/	3

Yugan	Water Resource Bureau	3-350	10-150	10-150
	Housing and Construction Bureau	37-720	/	/
	Agriculture and Rural Affairs Bureau	50-130	3-5	3-15
Fuliang	Water Resource Bureau	100		3-8
	Housing and Construction Bureau	EPC 3-8 300-500	/	/
	Agriculture and Rural Affairs Bureau	10	/	5

Competitive bidding is the most common procurement method under both the TBL and the GPL. Table 8 shows the share of contracts procured through competitive method for each of the 11 selected counties in FY 2020:

Table 8 - Procurement in FY 2020

Province/ County	Total value of procurement (RMB)	Total value of contracts procured through non- competitive method (RMB)	Total value of contracts procured through competitive method (RMB)	Percentage of competitive method by value (%)
<b>Hunan</b>				
Yuanling	1,865,495,400	9,134,000	1,856,361,400	99.51%
Miluo	1,613,971,348	186,536,042	1,427,435,306	88.44%
Wangcheng	7,820,073,400	0	7,820,073,400	100%
Ziyang	1,016,088,350	83,740,600	932,354,250	91.75%
Shimen	2,005,144,300	7,047,700	1,998,096,600	99.65%

<b>Jiangxi</b>				
Chongyi	327,100,000	2,600,000	301,100,000	92.05%
Dayu	536,630,000	129,000,000	407,630,000	75.96%
Yudu	1,722,020,000	100,000,000	1,622,020,000	94.19%
Yongfeng	469,510,000	93,000,000	377,510,000	80.40%
Yugan	2,680,000,000	0	2,680,000,000	100%
Fuliang	6,560,106,900	90,688,900	6,469,418,000	98.62%

Note: The data do not include very small contracts. The thresholds for very small contracts vary from county to county with RMB 0.2-0.5 million for works, RMB 0.1-0.2 million for goods, and RMB 0.1-0.2 million for services.

During the FSA, data were also collected on cancellation and re-bidding of procurements (see Table 9). There are very few cancellation and re-bidding. The reasons for cancellation and re-bidding include that none of the bidders meet the qualification requirements, that some major work or goods items are left out in the issued bidding documents, or that the lowest evaluated responsive bid price significantly exceeds the cost estimate.

Table 9 - Number of cancellations and re-bids

Province/ County	Implementation agency	Total number of contracts			Number of cancellations and re- bids		
		2018	2019	2020	2018	2019	2020
<b>Hunan</b>							
Yuanling	Water Resource Bureau	3	1	9	0	0	0
	Housing and Construction Bureau	9	10	29	0	0	0
	Agriculture and Rural Affairs Bureau	3	0	1	0	0	0
Miluo	Water Resource Bureau	7	3	3	0	0	0

	Housing and Construction Bureau	16	22	27	0	1	1
	Agriculture and Rural Affairs Bureau	8	28	29	0	1	1
Wangcheng	Water Resource Bureau	71	39	45	0	0	0
	Housing and Construction Bureau	3	1	0	0	0	0
	Agriculture and Rural Affairs Bureau	0	8	15	0	0	0
Ziyang	Water Resource Bureau	4	6	1	0	0	0
	Housing and Construction Bureau	3	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	0	23	0	0	0	0
Shimen	Water Resource Bureau	7	14	23	1	0	1
	Housing and Construction Bureau	17	5	29	0	0	0
	Agriculture and Rural Affairs Bureau	17	35	30	0	0	0
<b>Jiangxi</b>							
Chongyi	Water Resource Bureau	4	5	0	0	0	0
	Housing and Construction Bureau	5	3	2	0	0	0
	Agriculture and Rural Affairs Bureau	1	5	5	0	0	0
Dayu	Water Resource Bureau	5	2	2	0	0	0
	Housing and Construction Bureau	55	11	25	1	1	0
	Agriculture and Rural Affairs Bureau	0	0	4	0	0	0
Yudu	Water Resource Bureau	8	6	2	0	0	0
	Housing and Construction Bureau	112	53	55	8	3	5
	Agriculture and Rural Affairs Bureau	54	53	59	0	1	1
Yongfeng	Water Resource Bureau	4	8	1	0	0	0
	Housing and Construction Bureau	54	16	17	2	1	1

	Agriculture and Rural Affairs Bureau	0	1	3	0	0	0
Yugan	Water Resource Bureau	24	16	38	0	0	0
	Housing and Construction Bureau	1	1	6	0	0	0
	Agriculture and Rural Affairs Bureau	17	32	35	0	0	0
Fuliang	Water Resource Bureau	10	14	0	0	0	0
	Housing and Construction Bureau	20	16	45	0	0	0
	Agriculture and Rural Affairs Bureau	10	2	2	0	0	0

### 3.2.3.3 Institutional procurement arrangements

Four parties are usually involved in the procurement process:

1. The implementation agency (the client). The implementation agency assumes the responsibility for procurement as well as contract implementation, which includes: procurement planning and preparation of the budget, preparation of the bidding documents, organizing the procurement, participation in the bid evaluation, signing and execution of the contract, supervising the quality of the works, and ensuring compliance with the contract terms.
2. Procurement agent: Each client will hire an independent external procurement agent. The agent's responsibilities include assisting with the preparation of the commercial part of the bidding documents, publishing the invitation for bids, issuing the bidding documents, opening the bids publicly, organizing the bid evaluation (but not being a member of the BEC), and preparing the bid evaluation report.
3. Design institute: Each client will also hire an external design institute. The responsibility of the design institute is to assist the client in preparing the technical part of the bidding document.

4. The public resources transaction center: If the cost estimate of the contract exceeds the specified threshold, the procurement activities are carried out via the platform provided by the public resources transaction center.

### 3.2.4 Contract administration and performance

Once the contract is awarded, the client signs the contract with the contractor, supplier or consultant selected. The client is responsible for contract administration throughout the contract implementation period. The contractor, supplier or consultant should not assign the contract to another party. However, subject to prior concurrence of the client, the contractor or consultant may sub-contract some works and assignments as long as they are not critical components or activities.

Regarding the timeliness of contract completion, most contracts are completed within the contractual period. However, 55 out of 272 contracts (20.2%) in Hunan could not be completed within the contractual completion time, and 58 out of 254 contracts (22.8%) in Jiangxi could not be completed within the contractual completion time, the longest delay was one year; some contract completion audit could not be conducted timely. Table 10 provides information for a number of contracts executed by implementation agencies in each county. Causes for time slippage include, among other things, unforeseen geological events, change of design, bad weather, impact of COVID-19 and delay caused by lengthy land acquisition procedures.

Table 10 - Timeliness of contract completion

Province/ County	Implementation agency	Number of contracts surveyed	Number of contracts completed within initial contract period	Number of contracts with time slippage	Percentage of time slippages against initial contract period

Hunan					
Yuanling	Water Resource Bureau	13	10	3	Contract 1: 16% (180/210 days) Contract 2: 16% (180/210 days) Contract 3: 16% (180/150 days)
	Housing and Construction Bureau	10	10	0	n/a
	Agriculture and Rural Affairs Bureau	4	4	0	n/a
Miluo	Water Resource Bureau	9	7	2	Contract 1: 25% (120/150 days). Contract 2: 71% (180/308 days).
	Housing and Construction Bureau	10	/	/	All contracts not completed
	Agriculture and Rural Affairs Bureau	10	6	4	Contract 1-4: 33% (90/120 days).
Wangcheng	Water Resource Bureau	10	10	0	n/a
	Housing and Construction Bureau	1 PPP	/	/	1 PPP contract in implementation
	Agriculture and Rural Affairs Bureau	10	10	0	n/a
Ziyang	Water Resource Bureau	4	3	1	Contract: 61% (135/217 days)

	Housing and Construction Bureau	8	6	2	Contract 1: 24% (300/372 days) Contract 2: 10% (300/330 days)
	Agriculture and Rural Affairs Bureau	10	10	0	n/a
Shimen	Water Resource Bureau	7	7	0	n/a
	Housing and Construction Bureau	10	10	0	n/a
	Agriculture and Rural Affairs Bureau	10	10	0	n/a
<b>Jiangxi</b>					
Chongyi	Water Resource Bureau	7	7	0	n/a
	Housing and Construction Bureau	10	10	0	n/a
	Agriculture and Rural Affairs Bureau	7	7	0	n/a
Dayu	Water Resource Bureau	10	10	0	n/a
	Housing and Construction Bureau	9	0	9	All contracts could not be completed within contractual completion time

	Agriculture and Rural Affairs Bureau	1	/	/	the contract is under implementation
Yudu	Water Resource Bureau	8	2	5	Contract 1: 16.6% (12/14 months) Contract 2-4: 50% (4/6 months) 1 contract under implementation
	Housing and Construction Bureau	7	3	4	Contract 1: 33% (6/8 months) Contract 2: 30% (100/130 days) Contract 3: 200% (6/18 months) Contract 4: 33% (90/120 days)
	Agriculture and Rural Affairs Bureau	10	3	7	2 contracts: 33% (45/60 days) 5 contracts: 16.6% (120/140 days)
Yongfeng	Water Resource Bureau	10	6	4	3 contracts: 5% (365/385 days) 1 contract: 50% (12/18 months)
	Housing and Construction Bureau	10	10	0	n/a
	Agriculture and Rural Affairs Bureau	4	4	0	n/a
Yugan	Water Resource Bureau	10	10	0	n/a
	Housing and Construction Bureau	10	10	0	n/a
	Agriculture and Rural Affairs Bureau	10	0	10	6 contracts: 32-42% 4 contracts: 4-7%

Fuliang	Water Resource Bureau	10	7	3	2 contracts: 8% (12/13 months) 1 contract: 16% (12/14 months)
	Housing and Construction Bureau	10	2	1	7 contracts are under implementation 1 contract was delayed due to COVID-19
	Agriculture and Rural Affairs Bureau	3	3	0	n/a

In terms of cost control, cost variation may occur during contract implementation, leading to additional costs and cost overrun. Variations are handled in accordance with the terms and conditions of the contract. Their final value is subject to strict clearance depending on the value of the variation and local regulations. For example, for contracts in the water and construction sector, variations are first certified by the project supervision engineer and then endorsed by the relevant client staff at the site. They are subsequently submitted to the relevant water and construction bureau for clearance and to the local financial bureau for final approval.

Table 11 presents information on cost overruns for a number of historical contracts for each county. Causes for cost overrun include, among other things, unforeseen geological events, design changes/the need for additional works or delay caused by lengthy land acquisition procedures.

Table 11 - Cost overrun

County	Implementation agency	Number of contracts surveyed	Number of contracts	Range of cost	Number of contracts with cost
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			with cost overrun	overrun (in %)	overrun > 15%
<b>Hunan</b>					
Yuanling	Water Resource Bureau	3	2	C1: 1.5% C2: 1.3%	0
	Housing and Construction Bureau	10	6	4 C: 5-10%	0
	Agriculture and Rural Affairs Bureau	4	0	n/a	0
Miluo	Water Resource Bureau	9	2	C1: 5.58% C2: 9.18%	0
	Housing and Construction Bureau	10	All 10 contracts are not completed		
	Agriculture and Rural Affairs Bureau	10	8	5 contracts: 4.4-6.6%.	C1: 17% C2: 21% C3: 30%
Wangcheng	Water Resource Bureau	10	All 10 contracts are under completion audit, no final amount available		
	Housing and Construction Bureau	1	This is a PPP contract, which is under implementation		
	Agriculture and Rural Affairs Bureau	10	All 10 contracts are under completion audit, no final amount available		
Ziyang	Water Resource Bureau	3	0	n/a	n/a

	Housing and Construction Bureau	8	8	4 Cs:1-3% 2 Cs:4-8% 2 Cs: 10-11%	0
	Agriculture and Rural Affairs Bureau	10	2	C1: 10% C2: 11%	n/a
Shimen	Water Resource Bureau	7	0	n/a	n/a
	Housing and Construction Bureau	10	1	C1:7%	n/a
	Agriculture and Rural Affairs Bureau	10	0	n/a	n/a
<b>Jiangxi</b>					
Chongyi	Water Resource Bureau	2/10 no cost overrun	8 contracts under audit	n/a	n/a
	Housing and Construction Bureau	1	under audit	n/a	n/a
	Agriculture and Rural Affairs Bureau	7	0	n/a	n/a
Dayu	Water Resource Bureau	10	All 10 contracts are under completion audit, no final amount available*		
	Housing and Construction Bureau	3/10 no cost overrun	7 contracts uncompleted	n/a	n/a
	Agriculture and Rural Affairs Bureau	1	uncompleted	n/a	n/a

Yudu	Water Resource Bureau	4	0	n/a	n/a
	Housing and Construction Bureau	3	2	C1: 12%	C1:18.66%
	Agriculture and Rural Affairs Bureau	8	0	n/a	n/a
Yongfeng	Water Resource Bureau	8	1	C1: 8.72%	n/a
	Housing and Construction Bureau	2, 8 contracts are under implementation	1	/	28%
	Agriculture and Rural Affairs Bureau	4	0	n/a	n/a
Yugan	Water Resource Bureau	10	0	n/a	n/a
	Housing and Construction Bureau	1/10	9 contracts under audit	n/a	n/a
	Agriculture and Rural Affairs Bureau	10	1	C1: 1.27%	n/a
Fuliang	Water Resource Bureau	5	0	n/a	n/a
	Housing and Construction Bureau	10	All 10 contracts are under implementation		
	Agriculture and Rural Affairs Bureau	3	0	n/a	n/a

Note: \* contract completion audit was delayed due to COVID-19.

As for quality control, the supervision engineer and the client are responsible for daily oversight and quality supervision. The client is responsible for organizing final acceptance. Final acceptance is jointly conducted by

representatives from the relevant government agencies, such as the local finance bureau, the environment protection bureau, the land resources bureau, the water bureau, the housing and urban-rural development bureau, and the quality and technology supervision bureau, as well as representatives of the client, in accordance with the applying national specifications or national code and regulations. The survey showed that no major quality or performance issues have occurred for the surveyed contracts in the 11 selected counties.

Payment is made by the client to the contractor, supplier or consultant in accordance with the terms and conditions of the contract and without major delay. Normally, payment is made one to four weeks after the payment application is issued by the client. However, for most contracts, payment to the contractor, supplier or consultant will halt once the total payment made reaches a certain percentage (normally 80 percent) of the total contract amount. The remaining 20 percent are paid once the government audit of the project is concluded. It normally takes two to six months for the government audit to be concluded after the project is completed and taken over by the client.

An efficient dispute resolution procedure is included in each contract. In case of a dispute, the first option is an amicable settlement between the two contract parties. If no agreement is reached, the dispute is referred to the relevant government supervision authorities for adjudication. If either party is dissatisfied with the recommendation of the adjudicator, the party can refer the dispute further to either the local arbitration commission or the court. Usually, contracts provide for both parties to invoke the arbitration or lodge the legal suit.

Contractual remedies are specified in the signed contract. The client is entitled to terminate the contract in case of default of the contractor, supplier or consultant. This requires a written notification served in due course by the client to the other party.

### 3.3 Internal controls

#### 3.3.1 Internal controls

The Chinese Government takes internal control in the public sector very seriously. The Regulation on Internal Control of Administrative and Public Service Units was issued by the MOF in 2012. It provides detailed instructions and guidance to all budgetary units on strengthening their internal control function. Moreover, a set of basic internal control standards and practical guidance were issued by the MOF in recent years, as reference for all public sector entities. In 2014, the MOF issued the Basic Internal Control Rules (Decree No. 40), which provide a good model for other ministries and subnational government entities. All public sector entities are required to prepare an annual internal control report.

There is adequate control over, and stewardship, of program funds, with well-defined delegation of authority. Following the national policy and regulations issued by the MOF and NDRC, the Provincial Governments have issued a series of regulations regarding fund management, implementation measures, and result verification procedures, etc. For example, in 2020 Hunan provincial finance department issued a decree (Xiancaiye (2020)#116) to regulate the management of the general transferring budget. In 2018 Jiangxi provincial government issued a decree named "Provincial River Basin Ecological Compensation Fund Management Measures" (Ganfufa (2018)#9) which provides guidance on managing the river basin compensation funds.

The PEFA assessment in 8 counties of Hunan province shows the segregation of duties is prescribed throughout the expenditure process with responsibilities clearly defined for each level. Commitment control applies to all payments made from the TSA. Actual expenditures are in line with the approved budget and do not exceed commitment amounts or projected available cash resources. The disbursement system provides a safe mechanism for authentication and signature confirmation, which prevents unauthorized access to the database.

In Jiangxi province, some counties have formulated special county-level ecological compensation fund management methods and it helps the county-level government to manage and use the funds more transparently and effectively. In Hunan province, related regulations have been established on ear-marked funds management to ensure the funds could be used for the intended purposes in the counties visited.

In the process of project implementation, the budgetary units strictly implement the "four systems" management, namely the project legal person responsibility system, project bidding system, project construction supervision system and contract management system. Provisions are made for project organization and implementation, project fund use and management, project supervision and acceptance, etc. Detailed practice including:

- Promote strictly according to procedures. All projects that receive compensation funds shall strictly implement the basic construction procedures of the project and proceed in accordance with relevant requirements and regulations.
- Strictly implement the project legal person system. According to the principle of the entity in charge will be the legal person of the project, the responsible sectoral entity is determined as the project responsible unit, and the first responsible person for project implementation is implemented.
- Strictly implement the bidding system. In accordance with the relevant regulations and requirements of bidding, in accordance with the principle of no reduction in procedures and shortened time, certain ceilings are set up for public bidding and invited bidding for the investment project.
- Strictly implement the project supervision system and contract management system. All projects implement engineering supervision system and strictly implement contract management system.
- Strengthen project implementation target performance evaluation management. In accordance with the performance priority financial fund management system, on the premise of determining the

total investment and protecting vested interests, according to the "one ruler" standard, the performance evaluation and performance commitment mechanism are introduced in the project application process to ensure that the project is declared, implemented, and managed.

In county's self-reporting of Jiangxi province, it is noted that according to the decree the county governments are responsible for the arrangements and are supervised by the development and reform commissions and finance bureaus. However, it does not clarify the respective supervision content of the development and reform commissions and finance bureaus, nor does it stipulate that the ecological compensation funds must be used for fixed asset investment, and there is no requirement that it must be arranged for specific construction projects. There are no clear instructions on how to supervise and what is supervised by the commission and bureaus.

The Bank reviewed the county's self-reporting and noted that the counties were only required to submit the reports for FY2017 and FY2018, but not for FY2019. Some counties did not submit the required reports, but no actions were taken by provincial entities. In addition, according to decree #9 PDRC and PFD should cooperate with related government entities to conduct supervision and audit on usage of the compensation funds. However, such requirement was not implemented as required and no supervision and audit were carried out by related provincial government entities. The budget performance evaluation division initiated performance evaluation on the budget execution of the transferred funds from national and provincial government and some compensation funds distributed in FY2019 were included in this evaluation. But there are not specific supervision and audit reports on the mentioned "Provincial River Basin Ecological Compensation Fund". In Hunan province, the counties were not required to report program expenditure regularly and the monitoring and supervision on program expenditures from provincial level is absent. Therefore, provincial entities involved should strengthen the supervision on program funds in line with related government regulations.

Verification of the achievement of DLIs will rely on an independent third-party verification agent (VA) through on-site review. A detailed verification protocol has been designed and is reflected in the PAD.

#### Internal control for procurement

For procurement following the TBL, daily procurement is under the supervision and oversight of the Development Reform Commission and relevant sectoral government agencies at high level. For procurement following the GPL, daily procurement is under the supervision and oversight of the finance authority and relevant sectoral government agencies at high level.

In terms of procurement decisions, a procurement plan is prepared by the client. It is subject to clearance and approval by its supervision authority and the finance bureau. The qualification and evaluation criteria are set by the client in the issued bidding document. The contract award recommendation is made by the BEC on basis of these criteria. The decision for contract award cannot be overruled by the client. In case the decision for contract award needs to be revised, the BEC needs to re-convene.

With respect to the transparency and confidentiality of the procurement process, procurement is conducted via the platform of the public resources transaction center, if the contract value exceeds the specified threshold. This process is witnessed by staff of the transaction center and supervised by inspection staff from the relevant government agencies. The bid opening and evaluation are carried out at the center. If the procurement is processed outside the transaction center, the client's inspection staff and the staff from the DRC or local finance authority witness and supervise the bid opening and evaluation.

The agencies involved in the procurement process include the client, the procurement agent company, and the public resources transaction center. All agencies have clear mandates, a clear segregation of function, and clearly defined responsibilities for different units and staff. Ethical standards apply to all their staff when carrying out their daily work.

All procurement documents are kept for a specified time period. According to the TBL, procurement documents must be retained for at least ten years after completion of the procurement. According to the GPL, procurement documents must be kept for at least 15 years after completion of the procurement.

### 3.3.2 Internal audit

Internal audit practice complies with the Audit Law and the related regulations as issued by the China National Audit Office (CNAO). Article 3 of the CNAO Decree No. 11 of 2018 defines five types of internal audit: financial revenue and expenditure audit, accountability audit, performance audit, audit of the implementation of key policies, and internal control and risk audit.

The county audit offices are responsible for the supervision of, and technical guidance on, the internal audit work conducted by the budgetary units. According to PEFA assessment in 8 counties of Hunan province, some budgetary entities with subordinates have established an internal audit function. However, no specific internal audits were planned on the mentioned compensation funds by the sectoral budget units.

Based on the interviews on counties visited, it was noted that internal audit function had not been widely established within county budgetary units, however, the supervision and performance evaluation unit (the unit responsible for the internal audit) within county finance bureau sometimes carried out its supervision on the usage of compensation funds.

### 3.3.3 Program governance and anticorruption arrangements

#### *3.3.3.1 Complaints and reviews*

##### Complaint Mechanism for Procurement following the TBL

Two tiers of complaint handling exist for procurement following the TBL. Under the first tier, the bidder can lodge any complaint to the client with a view to the bidding documents, the bid opening, or the contract award recommendation. The contract award recommendation is required to be disclosed for at least three calendar

days. Any complaint regarding the contract award recommendation must be submitted within this standstill period. The client is required to respond to the complaint within three calendar days.

Under the second tier, the bidder can lodge any complaint to the relevant supervision authority regarding the bidding documents, the bid opening, the contract award recommendation, or other non-compliance of the procurement process with the relevant laws, rules, and regulations within ten calendar days from his/her awareness of the issue. Within three working days, the supervision authority shall determine whether the complaint is valid. If the complaint is determined valid, within 30 working days, the supervision authority shall issue its written judgement and determination. If the complainant is not satisfied with the resolution, the complainant is entitled to request an administrative review by an high level government office or administrative litigation.

#### Complaint Mechanism for Procurement following the GPL

Similarly, for procurement under the GPL, there exist two tiers of complaint handling. Under the first tier, the bidder can lodge any complaint to the client regarding the bidding documents, the procurement processing, the contract award recommendation, or other non-compliance of the procurement processing with relevant laws, rules, and regulations within seven working days from his/her awareness of the issue. The client is required to respond to the complaint within seven working days.

Under the second tier, if the bidder is not satisfied with the response from the client or if the client does not respond within the required time, the bidder can lodge any complaint to the relevant supervision authority regarding the bidding documents, the bid opening, the contract award recommendation, or other non-compliance of the procurement processing with relevant laws, rules, and regulations within 15 working days after receiving the response from the client or after expiry of the required responding time, as the case is applicable. Within 30 working days, the supervision authority must issue its written judgment and determination. If the bidder is not satisfied with the determination made by the supervision authority or if the

supervision government authority does not make its determination within the required time, the bidder can refer the matter to a high-level administrative review or invoke administrative litigation.

During the fiduciary assessment, information was collected about the complaints received in the past three years. The data are summarized in Table 12. All complaints are normally responded to within time, as specified by the TBL or GPL and the applying implementing regulations.

Table 12 - Complaints received

County	Implementation agency	Total number of contracts			Number of 1 <sup>st</sup> tier complaints			Number of 2 <sup>nd</sup> complaints		
		2018	2019	2020	2018	2019	2020	2018	2019	2020
<b>Hunan</b>										
Yuanling	Water Resource Bureau	3	1	9	0	0	0	0	0	0
	Housing and Construction Bureau	9	10	29	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	3	0	1	0	0	0	0	0	0
Miluo	Water Resource Bureau	7	3	3	0	0	0	0	0	0
	Housing and Construction Bureau	16	22	27	0	0	4	0	1	1
	Agriculture and Rural Affairs Bureau	8	28	29	0	1	0	0	1	0
Wangcheng	Water Resource Bureau	71	39	45	0	0	0	0	0	0
	Housing and Construction Bureau	3	1	0	0	0	0	0	0	0

	Agriculture and Rural Affairs Bureau	0	8	15	0	0	0	0	0	0
Ziyang	Water Resource Bureau	4	6	1	0	0	0	0	0	0
	Housing and Construction Bureau	3	0	0	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	0	23	0	0	2	0	0	0	0
Shimen	Water Resource Bureau	7	14	23	0	0	0	0	0	0
	Housing and Construction Bureau	17	5	29	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	17	35	30	0	0	0	0	0	0
<b>Jiangxi</b>										
Chongyi	Water Resource Bureau	4	5	0	0	0	0	0	0	0
	Housing and Construction Bureau	5	3	2	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	1	5	5	0	0	0	0	0	0
Dayu	Water Resource Bureau	5	2	2	0	0	0	0	0	0
	Housing and Construction Bureau	55	11	25	0	0	0	3	1	1
	Agriculture and Rural Affairs Bureau	0	0	4	0	0	0	0	0	0

Yudu	Water Resource Bureau	8	6	2	0	0	1	0	0	0
	Housing and Construction Bureau	112	53	55	3	3	2	2	2	1
	Agriculture and Rural Affairs Bureau	54	53	59	1	0	1	0	0	1
Yongfeng	Water Resource Bureau	4	8	1	0	0	0	1	0	0
	Housing and Construction Bureau	54	16	17	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	0	1	3	0	0	0	0	0	0
Yugan	Water Resource Bureau	24	16	38	0	0	0	0	0	0
	Housing and Construction Bureau	1	1	6	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	17	32	35	0	0	0	0	0	0
Fuliang	Water Resource Bureau	10	14	0	0	0	0	0	0	0
	Housing and Construction Bureau	20	16	45	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	10	2	2	0	0	0	0	0	0

### 3.3.3.2 Compliance with the Anti-Corruption Guidelines

The Chinese Government has put multiple institutions in place to combat fraud and corruption. They are designed to prevent, report, detect, investigate, prosecute, and sanction fraud and corruption. First, within all

implementation agencies involved in procurement, so-called discipline inspection commissions are in place that directly report to the discipline inspection commissions attached to higher-level supervision agencies. Second, there is the Ministry of Supervision at the central level with supervision departments/bureaus at the provincial, prefectural, and county levels. Third, under the Chinese People's Procuratorate, anti-corruption departments/bureaus have been set up at central, provincial, prefectural, and county level. Fourth, audit offices exist at central, provincial, prefectural, and county level, and all agencies involved in procurement are subject to an annual external independent audit. All these agencies have comprehensive mandates to combat fraud and corruption while carrying out procurement. Any bidder or any party can report fraud and corruption issues to any of these government agencies.

Still, the Bank may not be informed of fraud and corruption allegations during implementation of the Program. The Program manual will therefore require the client to regularly inform the Bank of any credible and material allegations of fraud and corruption in the Program progress report, as required in the loan agreement.

The Bank's right to conduct an inquiry into such allegations or other indications, independently of or in collaboration with the Borrower, regarding activities and expenditures supported by the Program, as well as its right to access to the required persons, information, and documents will be observed in accordance with the standard arrangements between the Government of the PRC and the Vice Presidency Integrity Department ('INT') of the Bank.

Procurement will be implemented by the implementation agency as established by each county, with assistance from the procurement agent company. These parties may not have knowledge of the firms and individuals debarred and temporarily suspended by the World Bank and other multilateral development banks. Therefore, there is a potential risk that contracts may be awarded to ineligible firms or individuals. The proposed mitigation actions are: (a) The Hunan and Jiangxi Provincial Development Reform Commission shall, upon project loan effectiveness, issue a high-level official letter or official instruction to the implementation

agencies to ensure that no contract will be awarded to ineligible firms or individuals. (b) Procurement staff at the Hunan and Jiangxi Provincial Development Reform Commission will check the latest Bank lists of debarred and temporarily suspended firms and individuals on a daily basis and share them with all implementation agencies. (c) the TOR for annual external audit includes the task of randomly selecting awarded contracts to check whether they have been awarded to ineligible firms or individuals.

### 3.4 Auditing

Jiangxi and Hunan Provinces and the counties receive various external audits and inspections throughout the year, primarily focusing on the proper usage of public funds. The annual external audit findings on budget execution by the provincial audit offices (PAO) are included in its annual report to the Provincial People's Congress, and the full audit report is published on the PAO official website. However, due to manpower shortage at the audit offices, not every budgetary unit is audited yearly. The audit strategy for government auditors is to conduct audit on a rolling basis, and for audit to cover multiple years.

The audit bureaus counties carry out audit on budget execution and have access to the necessary data without any restriction. A number of material issues and systemic and control risks are usually detected and disclosed in the audit reports, and remedial action is taken by the audited units effectively and timely. The audit bureaus submit their audit reports to the legislature in a timely manner, after receiving the financial reports. The standing committees of the county people's congresses provide timely approval of the audit reports and call for in-depth hearings on the main findings of the audit reports once a year.

Although government auditors indeed audit program funds when they carry out budget execution audit, accountability audit and other types of audits, no specific audit was conducted by provincial audit offices (PADs) and audit offices of interviewed counties on the usage of program funds in the past years. To mitigate this risk, annual program audit is required, and the audit of the proposed Program will be conducted by the provincial audit offices. Besides conducting the audit on budget execution and other provincial level entities,

the PAOs have been the auditors of Bank financed projects in two provinces for about three decades. They are the auditors the Bank accepted in China. The first year's audit report issued by the PAOs is subject to the quality review by the CNAO.

To gain reasonable assurance on the proper usage of Program funds, the CNAO and the PAOs will agree with the Bank on audit TOR and conduct annual Program financial statement audits that will be publicly disclosed. The CNAO and the PAOs will adopt the audit approach and coordination mechanisms used in other Bank-financed PforR operations. The PAOs will coordinate internally to minimize the chances of duplicate audits conducted by different auditors, and to maximize reliance on each other's findings. The auditors will conduct the financial audit on the PforR financial statements in accordance with the audit TOR to meet the Bank's audit requirements. The audit report will be submitted to the Bank within nine months of the end of the calendar year. Each provincial PAO will issue an audit report separately for its own part. It has been agreed that the Program audit would focus on the following aspects:

- Whether the transfers from central and provincial governments have been delivered to the counties timely and completely.
- Whether the Program funds are used properly and in line with the applying regulations and procedures, by sampling of Program counties.
- Whether the Bank's procurement and safeguard policies and requirements have been complied by all counties completely.
- Whether the domestic regulations and requirements have been strictly implemented.
- Whether the program financial reporting fairly presents the sources and utilization of program funds.

External audit for procurement

As mentioned, the agencies involved in procurement include the client, the procurement agent company and the public resources transaction center. All these agencies are subject to annual external audit. In addition, there are external project-specific audits for each project. During the project implementation period, the projects are selected randomly for project-specific annual external audit. Upon completion, each project is subject to an external project-specific audit. The audit not only covers the bidding process, but also contract implementation, including an assessment of whether proper procedures have been followed for the issuance of variations, whether these variations are reasonable, whether unauthorized sub-contracting or assignment of the whole contract to third parties has taken place, whether the payment paid to the contractor/supplier/consultant corresponds with the actual progress of works/goods delivery/service delivery, whether there are payment delays, etc..

### 3.5 Procurement and FM capacity

A project management office (PMO) has been set up at the provincial development and reform commission in both Jiangxi and Hunan provinces. PMO is responsible for coordinating and supervising the preparation and implementation of the proposed PforR operation. Jiangxi PMO is quite experienced on Bank operations and has been managing the Bank financed projects in Jiangxi province for three decades. It is not only capable of managing projects by international financial institutions (IFIs), but also shows strong support for the proposed Program. While the PMO in Hunan is quite new to Bank's operation and a consulting firm is hired to assist them on project preparation. But Hunan provincial finance department has extensive experience on IPF, PforR and DPO and is the PMO of a newly approved PforR project in Hunan province. Both provincial finance departments and PPMOs have adequate FM and procurement staff to manage program funds. The assessment also noted that related regulations and decrees associated with program had been established which provides detailed guidance to counties to implement program activities. All payments of program expenditures are made through government integrated financial management system.

The Bank also met with the representatives from provincial line departments in both provinces including forestry and grass land department, agriculture and rural affairs department, housing and rural urban construction department, water resources department, and ecology and environment protection department. In addition, several counties were interviewed during the preparation. It was observed that most government officials are familiar with the operation, including the required internal control procedures, the reporting process, annual budget preparation and implementation, etc. All necessary documents including a copy of each appropriation circular, and all regulatory documents issued by the provincial, municipal, and county governments are systematically filed.

The parties involved in procurement normally include the implementation agency, the procurement agent company and the design institute. Both the procurement agent company and the design institute are professional firms which possess sufficient human resources with the needed expertise, skills and experience. The implementation agencies have adequate experience in conducting the procurement and contract implementation. The procurement portfolios managed by the implementation agencies in the past three years are shown in Table 13.

Table 13 - Contracts procured in FYs 2018-2020

Province /County	Implementation agency	Category	Total number of contracts			Total contract value (RMB 10,000)		
			2018	2019	2020	2018	2019	2020
Hunan								
Yuanling	Water Resource Bureau	Works	2	0	1	1,856	0	1,142
		Goods	0	0	0	0	0	0
		Services	1	1	8	9.8	23.6	1,307
		Works	7	2	22	1,367.33	351.31	9,546.77

	Housing and Construction Bureau	Goods	1	0	2	118.50	0	41.6
		Services	1	8	5	1.818	342.8	268.87
	Agriculture and Rural Affairs Bureau	Works	0	0	0	0	0	0
		Goods	0	0	0	0	0	0
		Services	3	0	1	483.03	0	65.9
	Miluo	Water Resource Bureau	Works	7	3	3	10,183	6,038
Goods			0	0	0	0	0	0
Services			0	0	0	0	0	0
Housing and Construction Bureau		Works	16	22	27	72,297	67,904	243,490
		Goods	0	0	0	0	0	0
		Services	0	0	0	0	0	0
Agriculture and Rural Affairs Bureau		Works	6	22	23	1,049	7,208	7,579
		Goods	0	2	2	0	1,194	509
		Services	2	4	4	50.52	360	342
Wangcheng	Water Resource Bureau	Works	28	15	17	124,526	99,478	65,020
		Goods	1	0	1	1,500	0	600
		Services	42	24	28	1,868	1,492	985
	Housing and Construction Bureau	Works	1	0	0	6,612	0	0
		Goods	0	1	0	0	10,048	0
		Services	2	0	0	1,100	0	0
		Works	0	8	15	0	2,764	3,731
		Goods	0	0	0	0	0	0

	Agriculture and Rural Affairs Bureau	Services	0	0	0	0	0	0
Ziyang	Water Resource Bureau	Works	1	1	0	3,400	9,385	0
		Goods	0	2	0	0	2,170	0
		Services	3	3	1	186	475	10
	Housing and Construction Bureau	Works	1	0	0	11,800	0	0
		Goods	1	0	0	no data	0	0
		Services	1	0	0	259	0	0
	Agriculture and Rural Affairs Bureau	Works	0	18	0	0	3978	0
		Goods	0	0	0	0	0	0
		Services	0	5	0	0	183	0
Shimen	Water Resource Bureau	Works	1	5	4	28.6	2,586	3,728
		Goods	0	0	6	0	0	136
		Services	6	9	13	171	1,395	454
	Housing and Construction Bureau	Works	6	3	7	615	165	1,015
		Goods	3	2	1	369	177	80
		Services	8	0	21	60	0	65
	Agriculture and Rural Affairs Bureau	Works	4	4	2	2,956	3,442	4,382
		Goods	8	15	19	129	617	619
		Services	5	16	9	532	326	631
	<b>Jiangxi</b>							
Ch		Works	3	4	0	8526	5966	0

	Water Resource	Goods	0	0	0	0	0	0
	Bureau	Services	1	1	0	29	148	0
	Housing and	Works	2	1	2	6,229	1,519	1,476
	Construction	Goods	2	2	0	248	719	0
	Bureau	Services	0	0	0	0	0	0
	Agriculture and	Works	1	1	0	1950	1230	0
	Rural Affairs	Goods	0	3	4	0	41.2	29.6
	Bureau	Services	0	1	1	0	4.8	8.5
	Dayu	Water Resource	Works	5	2	2	2,855	1,906
Bureau		Goods	0	0	0	0	0	0
		Services	0	0	0	0	0	0
Housing and		Works	52	11	25	94,630	23,153	41,654
Construction		Goods	0	0	0	0	0	0
Bureau		Services	3	0	0	483	0	0
Agriculture and		Works	0	0	1	0	0	3,400
Rural Affairs		Goods	0	0	0	0	0	0
Bureau		Services	0	0	3	0	0	117
Yudu	Water Resource	Works	4	3	1	1,893	1,361	10,599
	Bureau	Goods	0	0	0	0	0	0
		Services	4	3	1	70	428	199
	Housing and	Works	99	45	34	375,474	288,333	685,677
	Construction	Goods	0	0	0	0	0	0
	Bureau	Services	13	8	12	3,591	2,704	3,035

	Agriculture and Rural Affairs Bureau	Works	42	41	44	14706	15253	16148
		Goods	0	0	0	0	0	0
		Services	12	12	15	576	581	625
Yongfeng	Water Resource Bureau	Works	3	8	1	6611	9824	574
		Goods	1	0	0	4398	0	0
		Services	0	0	0	0	0	0
	Housing and Construction Bureau	Works	53	14	16	43,378	34,248	43,497
		Goods	0	0	0	0	0	0
		Services	1	2	1	350	575	130
	Agriculture and Rural Affairs Bureau	Works	0	0	0	0	0	0
		Goods	0	0	0	0	0	0
		Services	0	1	3	0	44.5	157
Yugan	Water Resource Bureau	Works	10	7	15	5,918	15,075	37,847
		Goods	0	0	0	2,694	0	0
		Services	13	9	23	60	322	400
	Housing and Construction Bureau	Works	1	1	6	5380	1248	5578
		Goods	0	0	0	0	0	0
		Services	0	0	0	0	0	0
	Agriculture and Rural Affairs Bureau	Works	4	13	13	41,747	42,248	41,379
		Goods	1	1	1	768	456	330
		Services	12	18	21	1,107	1,245	1,220
Fuliang	Water Resource Bureau	Works	5	6	0	6,581	9,848	0
		Goods	0	0	0	0	0	0

	Services	5	8	0	175	525	0
Housing and Construction Bureau	Works	16	12	35	43,894	164,637	627,239
	Goods	0	0	0	0	0	0
	Services	4	4	10	119	843	3,098
Agriculture and Rural Affairs Bureau	Works	8	1	1	6642	3904	4531
	Goods	0	0	0	0	0	0
	Services	2	1	1	no data	no data	no data

Based on the assessment of the performance information and institutional arrangements, the fiduciary systems adopted have enough capabilities to ensure the successful implementation of the Program and the achievement of its development objectives.

#### **SECTION 4: PROGRAM SYSTEMS AND CAPACITY IMPROVEMENTS**

The overall fiduciary risk of the envisaged PforR operation is rated as 'substantial' given the proper implementation of the proposed mitigation measures:

Table 13 – Program system risks and mitigation measures

Risk	Mitigation action	Timing	Type of action (PAP, DLI, etc.)
The contracts may be awarded to firms or individuals which are debarred or under temporary suspension by the Bank or other multilateral development banks.	<ul style="list-style-type: none"> <li>▪ The Hunan and Jiangxi Provincial Development Reform Commission shall, upon project loan effectiveness, issue a high-level official letter or official instruction to implementation</li> </ul>	Implementation	PAP

	<p>agencies to ensure that no contract will be awarded to ineligible firms or individuals.</p> <ul style="list-style-type: none"> <li>▪ One of the duties of the procurement staff at the Hunan and Jiangxi PMO will be to check the latest Bank lists of the debarred and temporarily suspended firms and individuals before contract award to ensure that contract being awarded to eligible firm or individual.</li> <li>▪ The TOR for annual external audit includes the task of randomly selecting awarded contracts to check whether they have been awarded to ineligible firms or individuals.</li> </ul>		
<p>The Bank may not be informed of any credible and material allegations of fraud and corruption during the implementation of the Program.</p>	<p>The Program manual will require the client to regularly inform the Bank of any credible and material allegations of fraud and corruption in the Program</p>	<p>Implementation</p>	<p>PAP</p>

	progress report, as required in the loan agreement.		
The financing sources of program is quite comprehensive which integrating funds from very broad sources and some of them are one time compensation funds; Budget quota was distributed to counties/cities in batches and some program funds were delivered in the second half year or even the year end which prevents the county government from including the entire program funds in its annual budget and delays the implementation of planned activities.	Multiple-year program budgeting should be prepared to ensure program funds could be secured and county government could prioritize its investment to enhance the efficiency of its scarce financing resources; Provincial entities should revisit their budget quota distribution and take actions to ensure the budget quota could be distributed to county/city in advance.	Implementation	PIP
'Program' is not a budget classification element in China and the required Program financial reporting can't be generated from government treasury system;	A blue tagging mechanism which can trace program expenditures from government existing integrated financial management system has been recommended and it is expected to be piloted during project implementation, especially in those demonstration counties. Provincial finance departments will decide when and how to implement this piloting by	Implementation	PIP

	considering the readiness of government reform on the integrated financial management information system.		
No requirement by provincial government on reporting of program expenditures in Hunan province and the reporting requirement stipulated in government decrees were not strictly implementation in Jiangxi province.  Absence of efficient supervision by related provincial entities on the usage of program funds may bring potential risk of improper use of program funds.	Related decrees on program expenditure supervision should be set up in Hunan province.  Provincial entities involved should strengthen the supervision on program funds in line with related government decrees. Guidance and training should be provided on supervision and performance evaluation unit as they are performing the internal audit function.	Implementation	<b>PIP</b>
Government auditors did not audit the program funds and prepared the program audit report.	The Bank will work with the Provincial Audit Offices (PAO) to develop the terms of reference (TOR) for program auditing to ensure program funds could be audited in line with the Bank's policy.	Implementation	

<p>In Jiangxi the most common procurement method is the Price Commitment Method. The Price Commitment Method displays the procurement principles of being open, fair and transparent but it is questionable as to whether it offers value for money as the price is predetermined and bidders can't offer a lower price.</p>	<p>For value for money to be achieved it is critical that the cost estimating process is robust and that unit prices are regularly updated to ensure the cost estimate is as accurate as possible.</p>	<p>implementation</p>	<p>PIP</p>
<p>Based on the analyses of the contract administration, most contracts were completed within the contractual period. However, 55 out of 272 contracts (20.2%) in Hunan and 58 out of 254 contracts (22.8%) in Jiangxi could not be completed within the contractual completion time, the longest delay was one year; some contract completion audit could not be conducted timely.</p>	<p>Procedures or a guidance note should be produced by Hunan and Jiangxi Provincial Development Reform Commission that clearly define the undertaking of contract administration responsibilities in line with the Regulatory Framework.</p>	<p>Implementation</p>	<p>PIP</p>

## **SECTION 5: PROGRAM IMPLEMENTATION SUPPORT**

During Program implementation, the proposed fiduciary implementation support includes:

- Work with the team to review Program implementation progress, including the achievement of Program results and implementation of the PAP.
- Work with the team to assess timeliness and adequacy of Program fund appropriation as approved in the budget.
- Continuously assess and monitor the performance of the FM and procurement systems under the Program and provide suggestions for enhanced efficiency and effectiveness.
- Monitor application of the PforR anti-corruption guidelines.
- Monitor the performance of the fiduciary systems and the audit report, including the implementation of the PAP.
- Monitor the PforR financial statement reporting process and assist the client as necessary.
- Monitor the contracts implementation, including cost, time and quality control.
- Help the client resolve implementation issues and carry out institutional capacity building;
- Assist CNAO and the audit offices at provincial and county level in strengthening audit arrangements.
- Hold regular trainings for provincial and county audit offices, particularly with respect to procurement post audit to build capacity.
- Monitor changes in fiduciary risks of the Program and, as relevant, compliance with the fiduciary provisions of legal covenants.