



# Report and Recommendation of the President to the Board of Directors

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Project Number: 49409-001  
March 2016

## Proposed Technical Assistance Loan Erdenes Mongol LLC Strengthening Institutional Framework and Management Capacity Project (Guaranteed by Mongolia)

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Asian Development Bank



## CURRENCY EQUIVALENTS

(as of 8 March 2016)

Currency unit	–	togrog (MNT)
MNT1.00	=	\$0.00049
\$1.00	=	MNT2,042.50

## ABBREVIATIONS

ADB	–	Asian Development Bank
MIS	–	management information system
PAM	–	project administration manual
PIU	–	project implementation unit

## NOTE

In this report, "\$" refers to US dollars.

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## PROJECT AT A GLANCE

1. Basic Data		Project Number: 49409-001	
Project Name	Strengthening Institutional Framework and Management Capacity Project	Department /Division	EARD/EAPF
Country Borrower	Mongolia Erdenes Mongol LLC	Executing Agency	Erdenes-MGL, LLC
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Reforms of state owned enterprises		35.00
		Total	35.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Organizational development	Some gender elements (SGE)	✓
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		35.00	
Sovereign TA loan: Ordinary capital resources		35.00	
Cofinancing		0.00	
None		0.00	
Counterpart		6.20	
Government		6.20	
Total		41.20	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed technical assistance loan to Erdenes Mongol LLC, to be guaranteed by Mongolia, for the Strengthening Institutional Framework and Management Capacity Project.<sup>1</sup>

2. The project aims to support ongoing reforms to strengthen institutional framework and management capacity of Erdenes Mongol, a state-owned investment (asset management) company established in 2007. As legislative and regulatory reforms are being made to enable Erdenes Mongol to manage the state-owned assets more effectively to benefit the welfare of all Mongolian people, the project provides essential capacity development support to help Erdenes Mongol fulfill its evolving mandate of managing various state-owned assets and investing in infrastructure to support Mongolia's economic diversification.

## II. THE PROJECT

### A. Rationale

3. Mongolia's economy relies heavily on the mining sector, which accounts for 20% of the gross domestic product.<sup>2</sup> This heavy dependence has made the country economically vulnerable to volatility in the international commodity market. At the same time, strategic investment in important economic infrastructure is necessary if Mongolia is to succeed in its effort to diversify its economy. Given a large land area with small and dispersed population, inadequate transport infrastructure is a critical obstacle to national unity and export growth. Yet, Mongolia does not have an effective mechanism to channel funds raised from its natural resources to strategic investments necessary for the development and diversification of the economy. The national development strategy for 2008–2021 identified this as a crucial economic challenge and since then efforts have been continued under successive governments.<sup>3</sup>

4. In Mongolia, the government plays an important role in investing in key economic areas. The government needs to ensure that the economic benefits derived from the development of the country's mineral resources are effectively invested to generate sustainable returns, while supporting national unity and economic diversification. Good governance is required for the state's investment and management of assets to be effective. Good governance demands efficiency, accountability, and transparency. Information on the processes and results of state investment decision-making needs to be made public. Moreover, if the state engages in investment activities, its role as a regulator needs to be clearly separated from its role as an investor to avoid conflicts of interest and ensure fairness and equality in the market.

5. The government created the 100% state-owned Erdenes Mongol in 2007 to manage state-owned assets and make state investments more strategic and effective.<sup>4</sup> Erdenes Mongol's portfolio has grown from holding shares of one mining company in 2010 to four

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> The second-largest component is wholesale and retail, which accounts for 17%. Government of Mongolia. 2013. *Achieving Millennium Development Goal: Fifth Progress Report*. Ulaanbaatar.

<sup>3</sup> Government of Mongolia. 2008. *Comprehensive National Development Strategy of Mongolia*. Ulaanbaatar.

<sup>4</sup> The company had a staff of 68 as of 2015. It comprised a chief executive office, with responsibilities for human resource management and legal matters; an infrastructure management department; a project management department; and a finance and accounting department that handles financial analysis and financial management. Erdenes Mongol held about MNT 2.4 trillion (\$1.2 billion) in assets, as of 2015, including non-mining and mining assets.

companies by 2015.<sup>5</sup> While government line ministries focus on policies and regulations in the sectors in which the state invests, Erdenes Mongol aims to manage state-owned assets and raise funds to invest in economic infrastructure for the benefit of the general public. Its establishment aimed at the bifurcation of the state's dual roles of regulator and investor, which is a prerequisite to achieving good governance. Erdenes Mongol is evolving into managing various state-owned assets in both mining and non-mining sectors, and investing in economic infrastructure to enhance economic diversification.<sup>6</sup>

6. However, Erdenes Mongol has not fully realized its potential in generating revenues and effectively leveraging funds for further investments. Its functionality, efficiency, and profitability have been limited by various constraints. Under the legal framework which originally established Erdenes Mongol, the company was treated as a public agency even though it is an investment company with its own budget, which is independent from the state budget. In addition, Erdenes Mongol did not have the authority to retain dividends from its investee companies; until recent amendment, the Human Development Fund, created in 2009, was the recipient of the dividends. Its status as a public agency also left it with limited managerial flexibility, and its compensation structure could not attract or retain competent professionals. The public sector requirements imposed on it also meant that it would take longer to process procurement or investments than it would as a commercial entity.

7. In February 2016, the Parliament approved the amendments to the Human Development Fund Law, authorizing Erdenes Mongol to retain dividends from its investee companies. Furthermore, under the amended law, the Charter of Erdenes Mongol, which was originally based on the State and Local Property Law, is being revised based on the Company Law.<sup>7</sup> These developments in the legal framework will strengthen Erdenes Mongol's financial position, and allow it to operate its business as a commercial entity. Based on the Company Law and its revised Charter, Erdenes Mongol's governance structure will also be reformed. It will have three independent directors in its nine-member board of directors. The board of directors will have the authority to appoint the executive director (i.e., the chief executive officer), in contrast to the earlier arrangement that the chief executive officer of Erdenes Mongol was appointed by the government. This reform will improve transparency in management and allow Erdenes Mongol to be managed commercially with little political interference in future.

8. The approval of the amendments to the Human Development Fund Law also calls for urgent and substantial improvement of Erdenes Mongol's institutional and management capacities to fulfill its evolving mandate. Currently, Erdenes Mongol does not have a clear corporate strategy with medium and long-term targets. It also does not have sufficient capacity to identify investment opportunities that are appropriate to support the country's economic diversification with adequate attention to environmental management.

9. The company's corporate structure must be reformed to ensure sound governance,

<sup>5</sup> In 2010, Erdenes Mongol was made responsible for 100% of shares of Erdenes Tavan Tolgoi, which operates a strategic mineral asset in Mongolia. As of January 2016, in addition to Erdenes Tavan Tolgoi, Erdenes Mongol holds shares in the following three mining companies as the majority shareholder: Shivee Ovoo (90% of the shares), Baganuur (75% of the shares), and Erdenes Mining Corporation (51% of the shares). As a minor shareholder, Erdenes Mongol also holds 34% shares of Oyu Tolgoi that operates a strategic mineral asset of Mongolia.

<sup>6</sup> Khazanah of Malaysia is a similar strategic company owned by the government.

<sup>7</sup> The amendments to Human Development Fund Law have been approved, and the amended Human Development Fund Law will be renamed as the Future Heritage Fund Law. The revised Charter of Erdenes Mongol will become effective in 2016, and it will be authorized to retain dividends from investee companies from 2017.



prudent risk management, and efficient administration.<sup>8</sup> It needs to adopt the management structure in line with its business functions to analyze business risks and opportunities, and make strategic investment decisions. It also needs to develop corporate functions to provide legal, economic, and market analyses and information to support the efficient and effective functioning of the management. While currently Erdenes Mongol's financial investment and risk division in its finance and accounting department can only carry limited financial analysis, the company must develop its asset and liability management capacity to ensure prudent risk management. Strengthening the financial management and social and environment management capacity is also essential for sound corporate governance and compliance management. For efficient administration, functions such as human resources management need to be improved. It is also necessary to establish clear business processes to promote efficient use of financial and human resources.

10. The interim country partnership strategy of the Asian Development Bank (ADB) for Mongolia for 2014–2016 identified economic diversification as a major medium-term development challenge facing the country. It also stressed the importance of efficient public sector management and the establishment of a sovereign wealth fund.<sup>9</sup> Strengthening Erdenes Mongol's institutional framework and management capacity will significantly contribute to the effective management of Mongolia's state-owned assets and making sound investments for the diversification of the national economy.

## **B. Impact and Outcome**

11. The impact of the project will be the effective management and use of Mongolia's state-owned assets for the benefit of the country's people. The expected outcome is Erdenes Mongol's capacity developed for its envisaged development.

## **C. Outputs**

12. The project will provide for capacity development and advisory services to deliver three intended outputs. It will not prepare feasibility studies or a detailed engineering design of an investment project.

13. **Output 1: Corporate strategy developed.** The project will analyze the new legal and business framework to assess the changing business environment and determine the best strategy for Erdenes Mongol to adopt for its operations. This will include examination of the potential for new fund-raising schemes and possibilities for holding state-owned enterprises in the non-mining sector. The project will also conduct a detailed institutional analysis of the company and will help develop a corporate strategy to identify its midterm and long-term targets and milestones.

14. **Output 2: Functional capability strengthened.** To strengthen Erdenes Mongol's management capacity, the project will help establish three management groups within the company and hire high-level management consultants to engage in these groups for a transitional period of about 2 years. An advisory experts group, a strategy and risk management group, and an executive management recruitment group will strengthen the management system and will play critical roles in helping managers make investment decisions and ensuring

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<sup>8</sup> The functional capacity of Erdenes Mongol was assessed based on its financial management, procurement, business practices, organizational structure and close consultation with its management.

<sup>9</sup> ADB. 2014. *Interim Country Partnership Strategy: Mongolia, 2014–2016*. Manila.

sound corporate governance, prudent risk management, and efficient administration. The project will also help Erdenes Mongol strengthen its existing functions: (i) financial management; (ii) human resources management; (iii) public relations; and establish new functions; (iv) environment and social management; (v) supply chain management; and (vi) asset and liability management. It will assist Erdenes Mongol in the hiring and retention of middle-level management consultants for these operations for the transitional period. Improvements in financial management will cover reporting, accounting, auditing, internal control, and the facilitation of external auditing by an audit firm.

15. The project will also help Erdenes Mongol review and reform its business processes to make them more efficient and enable the company to expand its businesses. The project will support its capacity development during the transitional period by providing Erdenes Mongol with the necessary training at various stages of reform for (i) senior management, (ii) unit heads, and (iii) general staff. The project will assess and strengthen the existing management information system (MIS) as it relates to supply chain management, project management, and financial management.

16. **Output 3: Investment capability strengthened.** The project will help Erdenes Mongol develop its ability to diversify its asset base to increase investments in infrastructure that Mongolia needs to support overall economic diversification. This will include the capacity to identify sound, appropriate investment opportunities and conduct due diligence. These will be achieved by providing the company with advisory and capacity development consulting services. The project will also help to identify state-owned assets for potential acquisition and conduct an institutional and legal assessment of the possibility of Erdenes Mongol holding non-mining assets.

#### D. Investment and Financing Plans

17. The project is estimated to cost \$41.2 million (Table 1).

**Table 1: Project Investment Plan (\$ million)**

Item	Amount <sup>a</sup>
<b>A. Base Cost<sup>b</sup></b>	
1. Corporate strategy developed	2.3
2. Functional capability strengthened	29.3
3. Investment capability strengthened	2.3
4. Project management support	3.2
<b>Subtotal (A)</b>	<b>37.0</b>
<b>B. Contingencies<sup>c</sup></b>	<b>2.4</b>
<b>C. Financing Charges During Implementation<sup>d</sup></b>	<b>1.7</b>
<b>Total (A+B+C)</b>	<b>41.2</b>

Note: Numbers may not sum precisely due to rounding.

<sup>a</sup> Includes about \$0.4 million in taxes and duties on goods. The following principles were followed in determining the amount of taxes and duties to be financed by ADB: (i) the amount is within reasonable country thresholds, (ii) the amount does not represent an excessive share of the project investment plan, (iii) taxes and duties apply only to ADB-financed expenditures, and (iv) the financing of taxes and duties is relevant to the success of the project. Employer's contribution for social security of individual consultants, imposed in Mongolia, to be financed from Erdenes Mongol's resources. Employer's social security contributions will be made directly by Erdenes Mongol to the relevant government agency.

<sup>b</sup> In mid-2015 prices.

<sup>c</sup> Physical contingencies computed at 5% for goods; and 5% for field research and development, training, surveys, and studies. Price contingencies computed at 2.19% on foreign exchange costs and 2.79% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

<sup>d</sup> Includes interest and commitment charges. Interest during implementation for the ADB loan has been computed at 3-year US dollar fixed swap rate corresponding to the implementation period plus an effective contractual spread of 0.5%. Commitment charges for an ADB loan are 0.15% per year to be charged on the undisbursed loan amount. Source: Asian Development Bank estimates.

18. Erdenes Mongol has requested a loan of \$35 million from ADB's ordinary capital resources to help finance the project. The loan will have a 15-year term, including a grace period of 3 years, annuity repayment method based on 30% discount factor, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions set forth in the loan agreement. Based on this, the average loan maturity is 12.1 years and there is no maturity premium payable to ADB. Financing charges will be capitalized in the loan.

19. The financing plan is in Table 2.

**Table 2: Financing Plan**

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Ordinary capital resources (loan)	35.0	85.0
Erdenes Mongol	6.2	15.0
<b>Total</b>	<b>41.2</b>	<b>100.0</b>

Source: Asian Development Bank estimates.

## **E. Implementation Arrangements**

20. The project will be implemented over 36 months from April 2016 to April 2019. Erdenes Mongol will be the executing agency. The company's office of the chief executive, led by the chief executive officer, will serve as the project management unit and be responsible for overall management of the project. A project implementation unit (PIU) will be established under the project management unit to implement and monitor the project. The loan proceeds will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time). Procurement will be done in accordance with ADB's Procurement Guidelines (2015, as amended from time to time), and recruitment of consultants will be done in accordance with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time).

21. The implementation arrangements are summarized in Table 3 and described in detail in the project administration manual (PAM).<sup>10</sup>

**Table 3: Implementation Arrangements**

Table of Implementation Arrangements			
Aspects	Arrangements		
Implementation period	April 2016–April 2019		
Estimated completion date	30 April 2019 (loan closing date: 31 October 2019)		
Management			
(i) Oversight body	Erdenes Mongol's office of the chief executive to serve as PMU		
(ii) Executing agency	Erdenes Mongol		
(iii) Key implementing agencies	Erdenes Mongol PIU to be established under PMU		
Procurement	National competitive bidding	1 contract (goods)	\$1.7 million
	Shopping	Multiple contracts (goods)	\$0.7 million

<sup>10</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

Aspects	Arrangements		
Consulting services	Quality- and cost-based selection (6 firms)	1 contract for 40 person-months (International law firm) 1 contract for 48 person-months (national law firm) 1 contract for 55 person-months international, 55 person-months national (management consulting firm) 1 contract for 48 person-months international, 48 person-months national (financial management firm) 1 contract for 36 person-months international, 96 person-months national (ICT firm) 1 contract for 36 person-months international, 36 person-months national (human resources management firm)	\$1.7 million \$0.8 million \$2.8 million \$2.0 million \$2.0 million \$1.4 million
	Individual consultant selection	538 person-months international (23 individuals), 510 person-months national (28 individuals)	\$18.0 million for international, \$2.6 million for national
Advance contracting	Individual consulting services to serve as PIU staff: 200 person-months—62 person-months international (\$1.9 million), 138 person-months national (\$0.7 million). Initial procurement activities include TOR preparation, advertisement, shortlisting, and selection. The contract to recruit the individuals will be signed after loan effectiveness.		
Disbursement	The loan proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2015, as amended from time to time) and detailed arrangements agreed upon between Erdenes Mongol and ADB.		

ADB = Asian Development Bank, ICT = information and communication technology, PIU = project implementation unit, PMU = project management unit, TOR = terms of reference.

Source: Asian Development Bank.

### III. DUE DILIGENCE

#### A. Economic and Finance

22. Erdenes Mongol is responsible for managing several kinds of state-owned assets and making economic investments. It also explores opportunities for strengthening its financial capacity and expanding its investments in the non-mining sector and other assets.

23. The project will strengthen Erdenes Mongol's institutional framework and management capacity, which will make it better able to manage state-owned assets and invest strategically and effectively. This is necessary to help Mongolia enhance its investment in economic infrastructure and diversify the economy. The project will support Erdenes Mongol to play an important role in leveraging additional funds for these types of investment. As an investment company with a strong financial base and greater expertise, it will be in a better position than the government to make investments on behalf of the state and to manage state-owned assets efficiently. As a state-owned enterprise, Erdenes Mongol can also take a longer-term view than a private company may possibly have, and this is particularly important to ensure that the country's natural resources are managed with long-term strategic objectives in mind.

24. The project's improvement of Erdenes Mongol capacity will yield direct economic benefits. The company will be able to manage its existing assets better at a reduced cost. In the short-term, Erdenes Mongol is expected to make investments financed by the below mentioned toll road revenues, and a management fee and dividends from its investee companies. The improved management of Erdenes Mongol would boost the performance of its investee companies, which will improve its own financial position. The improved financial position with strengthened financial strategies will help Erdenes Mongol leverage more funds to further expand its investment in the medium and long term. This will enable the company to make effective new investments in areas such as basic infrastructure and transport that are key to Mongolia's efforts to diversify the economy. Strengthening transport, especially by rail, is crucial to meet the landlocked country's need to expand its exports. Better internal and external transport connectivity will also spur economic growth in cities and regions beyond the major urban center and capital, Ulaanbaatar. Economic growth and diversification supported by future Erdenes Mongol investment will help raise the living standards of Mongolia's people.

25. An ADB financial analysis of Erdenes Mongol reviewed its past and projected financials. The company's audited financials for the years of 2012, 2013, and 2014 show annual operations losses. The losses grew in 2014 due to the addition of a toll road asset that was only gradually increasing its revenue base while incurring full operational costs. Erdenes Mongol's charter allows it to charge a management fee of 3% of operating costs to its investee companies, but it has not been charged yet. Erdenes Mongol plans to charge the management fee from 2016.

26. The legislation has been finalized for the proposed legal change to provide Erdenes Mongol with a new source of revenues that it has so far been denied—dividends from the companies in which it holds investments (para. 7). Because revenues from dividends will depend on the performance of the investee companies, the conservative scenario in ADB's financial analysis removed these sources from cash flows. In addition, ADB analysis conservatively adjusted projected toll road revenues downward by 50% to reflect current volatility in the commodities cycles. Nonetheless, the resulting projected cash flows remained adequate to meet Erdenes Mongol's debt servicing requirements, including those for the ADB project loan. To ensure financial sustainability, ADB has proposed loan covenants to require specific debt service coverage, debt-to-equity, and operating ratios. The sovereign guarantee also provides overall assurance that the loan will be repaid.

## **B. Governance**

27. Erdenes Mongol has a finance and accounting department and a separate internal audit unit with adequately qualified staff members who are either accountants or investment officers. They have appropriate experience of about 3 years on average in accounting and/or commercial investment firms. The company prepares its accounts in accordance with Mongolia's national accounting laws and rules, established by the Ministry of Finance. Based on the ministry's guidance for state-owned enterprises, Erdenes Mongol developed its own accounting policies and procedures. It has its annual financial statements prepared and audited in accordance with International Financial Reporting Standards. The finance and accounting department has a staff of 13, which is generally adequate for dealing with the company's current businesses, but would be too small for additional externally funded projects. The staff has no experience in implementing ADB-funded projects.

28. ADB's financial management assessment showed that Erdenes Mongol will need help to

implement the project. This support will include a financial management specialist to be engaged in the PIU staff and an audit specialist for external auditing of the project. The project will also provide guidance and training for Erdenes Mongol and PIU staff on ADB guidelines and procedures for (i) financial management and reporting; (ii) budget preparation and oversight; (iii) disbursement; (iv) the financial audit process and requirements; and (v) proper use of, and accounting for, the imprest accounts and the statement of expenditure.

29. The strengthening of Erdenes Mongol's overall financial management systems is a major project component and is needed to position the company to expand its activities. This financial management component will focus on (i) accounting policies and procedures for International Financial Reporting Standards; (ii) institutional arrangements for good governance; (iii) internal oversight and governance capacity, including stronger internal auditing; (iv) external oversight capacity for external audit and full compliance with the International Standards of Auditing; and (v) upgraded MIS and information and communication technology systems to accommodate the reformed financial management processes. ADB's assessment found that the project's pre-mitigation financial management risk was moderate and would be adequately mitigated through the measures planned under this project component.

30. Public procurement in Mongolia is conducted in accordance with the country's public procurement law, which requires the use of open competitive tendering and conflicts in no fundamental way with ADB's consultants' and procurement guidelines. The basic principles and requirements are largely the same. Mongolia has promulgated the Anticorruption Law, related regulations, and anti-fraud measures in public procurement. Erdenes Mongol has a full-time procurement specialist and about 10 related technical staff, as well as experience in managing projects supported by multilateral and bilateral development partners. The project will strengthen Erdenes Mongol's capacity in procurement in terms of efficiency and governance. It will also support the engagement by the PIU specialists to support the recruitment and procurement activities and ensure smooth implementation. Because these mitigating actions will reduce the potential risk for project procurement issues, this risk is considered to be low.

31. The government recognizes the risk of corruption in the public sector and established the Mongolian Anticorruption Agency in 2004 specifically to fight corruption at all levels of government. The agency's work includes oversight of the management of public expenditures, including those for procurement. Members of the selection committee for procurement sign the notice of the procurement for conflict of interest. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with Erdenes Mongol during the project preparation. The specific policy requirements and supplementary measures are described in the PAM (footnote 10).

### **C. Poverty and Social**

32. The project will provide the capacity development and advisory services for Erdenes Mongol. It is not expected to have a direct impact on poverty and social issues, but would have an indirect impact on poverty. Improving the management of state-owned assets and state investment will help diversify Mongolia's economy, which, in turn, would improve the overall welfare of the poor. The project will also strengthen the company's public relations, which will improve its communications with stakeholders, communities, and such groups as nonprofit organizations.

33. ADB has classified the project as *some gender elements*. It will provide capacity development support for female and male Erdenes Mongol staff and ensure that the women on

the staff benefit from this support equally with the men. It will provide a session targeted at female staff to enhance career development. The project will also develop a module on how to integrate the gender perspective into investment decision making processes including simple gender analysis tools.

#### **D. Safeguards**

34. **Environment.** The project is classified as category C for environment, since no adverse environmental impacts are expected from the project, which will not result in an investment project. The project will have positive environmental benefits. It will establish a social and environment management unit in Erdenes Mongol to ensure that the company complies with related laws and regulations. It will further help Erdenes Mongol develop its internal guidelines on environmental and social safeguards by establishing an environment and social management system meant to ensure continued compliance with Mongolia's environmental standards and to make the company's future investments environmentally and socially sustainable. In addition, the project will develop and implement a capacity development plan for Erdenes Mongol's staff to strengthen the company's environmentally and socially sustainable development knowledge.

35. **Resettlement.** The project's involuntary resettlement category is C. It will require neither land acquisition nor resettlement.

36. **Indigenous peoples.** The project is classified as category C for indigenous peoples. The assessment determined that the project will not affect ethnic minority communities directly or indirectly.

#### **E. Risk and Mitigating Measures**

37. Under the amended Human Development Fund Law, approved in February 2016, the Charter of Erdenes Mongol is being revised based on the Company Law. The approved legal reform strengthens Erdenes Mongol's legal status, and reduces political influence on its operations and associated risks. The integrated benefits and impacts are expected to outweigh the costs. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>11</sup>

**Table 4. Summary of Risks and Mitigating Measures**

<b>Risks</b>	<b>Mitigating Measures</b>
Political uncertainty in Mongolia could affect the project.	Erdenes Mongol was established in 2007 for strategic management of state-owned assets for the benefit of all people in the country. Given that it has been supported by successive governments since then, its sustainability is not considered to be an issue as to which political party will be in power. In addition, under the revised HDFL, the Charter of Erdenes Mongol is being revised based on the Company Law, which will change the authority of appointment of the executive director from the government to the board of directors of Erdenes Mongol. The board of directors will also include three independent directors in its nine members. These reforms further reduce political influence on Erdenes Mongol's operations.
Lack of familiarity with ADB procedures could delay project	The project will train the executing and implementing agencies and PIU staff who will assume day-to-day management of the project in

<sup>11</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

implementation.	the procurement, disbursement, and financial management requirements of applicable ADB guidelines, policies, and regulations.
Limited staffing in the implementing agencies may delay loan disbursement.	A PIU will be established to carry out day-to-day project activities, including financial management and procurement. It will comprise qualified and experienced professionals.

ADB = Asian Development Bank, HDFL = Human Development Fund law, PIU = project implementation unit.

Source: Asian Development Bank.

#### **IV. ASSURANCES**

38. Erdenes Mongol has assured ADB that implementation of the project shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents. In line with the sovereign guarantee, financial covenants will be included in the legal agreements for the project.

#### **V. RECOMMENDATION**

39. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the technical assistance loan of \$35,000,000 to Erdenes Mongol LLC, to be guaranteed by Mongolia, for the Strengthening Institutional Framework and Management Capacity Project, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and guarantee agreements presented to the Board.

Takehiko Nakao  
President

4 March 2016



## DESIGN AND MONITORING FRAMEWORK

[illegible]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
3. Erdenes Mongol's investment capability strengthened	2d. MIS-related ICT systems developed by installing related ICT systems by December 2018 (2015 baseline: 0)		
	2e. Capacity of human resources of Erdenes Mongol, including capacity to include gender perspective in decision making process, developed by March 2019		
	3a. Institutional and legal assessment of Erdenes Mongol potentially holding non-mining assets produced by March 2017	3a. A report on institutional and legal assessment	
	3b. Support for Erdenes Mongol to develop its ability to identify appropriate investment opportunities provided by September 2018	3b. A report on identified investment opportunities	
	3c. Support for Erdenes Mongol to develop its ability to identify potential state assets to be acquired provided by September 2018	3c. A report on state-owned assets identified for potential acquisition	
<b>Key Activities with Milestones</b> <b>1. Erdenes Mongol's corporate strategy developed</b> 1.1 Complete an analysis of the new legal and business framework to examine business environment, and identify Erdenes Mongol's optimal strategy to operate by Q1 2017 1.2 Complete institutional analysis of Erdenes Mongol by Q1 2017 1.3 Complete a corporate road map identifying the midterm and long-term targets and milestones by Q2 2017  <b>2. Erdenes Mongol's functional capability strengthened</b> 2.1 Complete the strengthening of management capacity by Q1 2019 2.1.1 Complete the set-up of management groups (advisory experts group, strategy and risk management group, and executive management recruitment group) by Q3 2016 2.1.2 Complete the recruitment of high-level management consultants for the management groups, and retain the consultants until Q1 2019 2.2 Complete reform of the corporate structure by Q1 2019 2.2.1 Complete the strengthening of existing functions (financial management, human resources managements, and public relations) by Q4 2018 2.2.2 Complete establishment of new functions (asset and liability management, social and environment management, and supply chain management) by Q4 2018			

2.2.3	Complete the recruitment of middle-level management consultants for the functions, and retain the consultants until Q1 2019
2.3	Complete the improvement of business processes by Q4 2018
2.4	Complete the development of the MIS and related ICT systems of financial management, project management, and supply-chain management by Q4 2018
2.5	Conduct capacity development training, including a session for female staff, for the staff of Erdenes Mongol until Q1 2019.
<b>3.</b>	<b>Erdenes Mongol's investment capability strengthened</b>
3.1	Complete the institutional and legal assessment of holding non-mining assets by Q1 2017
3.2	Complete provision of consulting support for developing Erdenes Mongol's ability to identify appropriate investment opportunities by Q3 2018
3.3	Complete provision of consulting support for developing Erdenes Mongol's ability to identify potential state assets to be acquired by Q3 2018
<b>Inputs</b>	
ADB: \$35.0 million (loan)	
Erdenes Mongol: \$6.2 million	
<b>Assumptions for Partner Financing</b>	
Not applicable.	

ADB = Asian Development Bank, ICT = information and communication technology, MIS = management information system, MNT = Mongolian Tugrik.

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://adb.org/Documents/RRPs/?id=49409-001-3>

1. Loan Agreement
2. Sovereign Guarantee Agreement
3. Sector Assessment (Summary): Public Sector Management (Reforms of State-Owned Enterprises)
4. Project Administration Manual
5. Contribution to the ADB Results Framework
6. Development Coordination
7. Country Economic Indicators
8. Summary Poverty Reduction and Social Strategy
9. Risk Assessment and Risk Management Plan

### **Supplementary Documents**

10. Financial Management Assessment
11. Financial Model Analysis