

AIDE MEMOIRE
ROMANIA FOREST DEVELOPMENT PROJECT
SUPERVISION MISSION, SEPTEMBER 12 THROUGH OCTOBER 2, 2006

INTRODUCTION

1. A World Bank Mission to supervise the Romania Forest Development Project (FDP) took place from September 12 to October 2, 2006. The mission was comprised of Peter Dewees (Task Team Leader, ECSSD), Bob Kirmse (Forest Specialist, ECSSD), and Doina Petrescu (Senior Operations Officer).
2. The objective of the mission was to assess overall performance and the achievements of the FDP since the previous Supervision Mission, and to evaluate, with counterparts, the extent to which the project's objectives continue to be met as well as progress in achieving expected development outcomes. Financial management and procurement issues were also reviewed during discussions with Project Management Unit (PMU) staff.
3. Discussions were held with staff of the Ministry of Agriculture, Forests and Rural Development (MAFRD), the National Forest Administration (NFA) and staff with the PMU. Field visits were made to Dambovita, Caras-Severin, Timis, Alba, and Maramures Counties to assess progress and conditions of six of the 17 road rehabilitation projects which have been approved for financing. Further discussions were held with the National Wood Institute (Institutul National al Lemnului), with WWF/Romania, and with staff of the Faculty of Silviculture at Brasov. The mission participated in a workshop convened by the Romanian Academy (Institute of Geography) to review research findings and policy implications of studies of the social impacts of forest restitution in Romania which are being carried out in cooperation with Oxford University. The mission also participated in discussions with the Preappraisal Mission of the Farm Restructuring Project, which was considering the scope for tackling issues related to forest restitution.
4. This Aide Memoire summarizes progress to-date, agreements reached with Government, and outlines issues and next steps. The Bank team would like to express its appreciation for the support and involvement of project and Ministry staff, and for the warm hospitality received.

Forest Development Project Status

Overall status

5. The Forest Development Project was formally launched in March 2004. The objective of the project is to maintain and to improve environmentally sustainable management of state and private forests so as to increase their contribution to the national and rural economies.
6. To date, implementation has been slow. Progress has been hindered because of extensive delays in effectiveness, far reaching institutional changes (i.e. subordination of the Forest Inspectorates to the Ministry of Control followed by their reversion to MAFRD), management disruptions caused by the election cycle (which resulted in delays in the approval of investment-related activities by MAFRD); and changes in Government policies with respect to the restitution of state forests.

7. Implementation delays have also been structural, and were related to the design of the project, particularly the Bank's environmental safeguard requirements which required completion of the 'Best Practice Guidelines for Forest Roads Construction and Rehabilitation' (which involved extensive internal and external consultations) before any substantive measures could be undertaken with respect to the forest roads rehabilitation activities, which account for around two-thirds of the loan proceeds.

8. Despite these implementation delays, significant progress has been made over the last year in a number of areas, and **overall performance is considered to be Satisfactory**. Particular progress is noted in completing the Forest Roads Best Practice Guidelines, tendering the first tranche of the forest roads rehabilitation civil works, launching preparation of the Strategic Development Plan for the NFA, providing support to the Associations of Private Forest Owners, preparing public awareness activities, and in designing and launching preparation of the Forest Management Information and Monitoring System (FMIMS). Cost estimates of the activities committed and planned are outlined in Table 1. Over 60 percent of project funds have been committed to date, or will be committed in the next several months through signed contracts.

Project Component	Estimated Project Cost, Planned	Actual Project Costs (Committed)		Procurement under way	Total committed or procurement under way	
	(000 US\$)	(000 US\$)	Percentage	(000 US\$)	(000 US\$)	Percentage
1. Establish Systems to Ensure Sustainable Management of Private Forest Lands	11,011	4,570	42%	750 ^{1/}	5,320	48%
2. Mitigate Consequences of Restitution on Management of State Forest Lands	18,166	11,127	61%	2,500 ^{2/}	13,627	75%
3. Support for Increased Competitiveness of Forest Industries (Forsbic)	749	0	0%		0	0%
4. Build Public Support for Sustainable Forest Management	789	663	84%		663	84%
5. Project Management and Coordination	1,176	638	54%		638	54%
Total	31,891	16,998	53%	3,230	20,248	63%
Notes						
1/ Bulk of procurement under way is accounted for by the FMIMS, which has been tendered.						
2/ Bulk of procurement under way is the second forest roads tranche. Tender documents are in preparation, to be completed by February 2007.						

9. Because of implementation delays, disbursements have lagged very considerably. To-date, less than 9 percent of project funds have been disbursed. The Mission noted that, based on outstanding commitments, the pace of disbursement should rapidly accelerate over the coming months. It is estimated that between June and December 2006, another \$3.6 million will be disbursed, and that total disbursements by end-2007 will exceed \$11 million.

Forest restitution

10. The 2005 restitution law resulted in a commitment vastly to increase the area of state forests to be restituted to their former private owners (above what was envisaged in the 1991 and 2000 restitution laws). This process, which is now underway, will eventually result in the restitution of around 4 million ha of forests in total (out of 6.4 million ha). This is *double*

the area of restituted forests which were envisaged at Appraisal, and poses significant new institutional and management challenges for the sector. It is also a tremendous opportunity for improving sectoral productivity and rural incomes in some of Romania's poorest areas. Once this round of restitution is completed, only around 35 percent of the pre-restitution forest area will remain under state control and management (compared with 65 percent currently). Because of its potential impact, the mission reviewed some of the issues surrounding forest restitution.

11. The question of the restitution of forest land -- and especially its impact on rural income -- is not trivial. If Government is going to reconstitute a total of 4 million ha of forest land (leaving an additional 2.4 million ha under state control), it represents a very significant transfer of assets from state to private ownership. Assuming a very conservative stocking density of 75 cubic meters of roundwood per ha (stocking densities in well-managed forests can be as high as 300 cubic meters), and a value on-the-stump of around US\$ 75 per cubic meter (values on-the-stump are reported to be around \$235 per cubic meter for oak, \$142 per cubic meter for beech, and around \$50 for softwoods), the standing value of this asset transfer is around US\$ 22.5 billion. This represents a huge infusion of capital to new private forest owners. Assuming a long-rotation of a hundred years, properly managed, it would be producing around \$220 million per year.¹

12. Given past experiences with forest restitution under the 1991 and 2000 restitution laws, once restitution is underway there is likely to be some considerable liquidation of forest assets, showing a temporary spike in rural incomes for a few years before leveling off. The potential impact on rural incomes could be quite substantial. At the same time, the industrial infrastructure needed to process large volumes of industrial wood is not in place -- and even if it were in place, it could not be kept operating at capacity in the long term because of eventual supply constraints.

13. The current round of forest restitution is of great importance and poses good opportunities for the Romanian economy. It also presents significant risks and exceptional challenges for the well-established and internationally respected traditions of sustainable forest management which have characterized the sector for a long time. Restitution, without an effective policy and institutional framework, will result in the loss of extensive areas of forest (including important natural habitats) to meet short term economic interests. These are concerns which are widely shared in Romania amongst foresters and civil society organizations.

14. The FDP was conceived and designed within a policy and institutional framework which did not envisage this very substantial transfer of forest assets to private owners. One of the challenges for project management and for the Ministry is to find ways of being responsive to new sectoral demands as a result of this significant change. In fact, plans for restitution affect the ability of the project to deliver on virtually every project component.

Changes in the National Forest Policy and Strategy

15. It was agreed during the previous Supervision Mission that, in light of the greatly expanded program of restitution, the 2001 National Forest Policy and Strategy (NFPS) would

¹ This would be an optimal outcome, but is still quite conservative. By comparison, in 2002, using the reported values of timber on-the-stump noted above, the total timber harvest of 16.4 million cubic meters was worth around \$1.6 billion.

be revised more fully to account for the increased area of restituted forests. This process has been completed. Partly because the 2001 NFPS framework was already comprehensive, revisions were relatively modest. These emphasize

- the importance of working with private forest owners associations and putting in place stronger measures to support sustainable forest management of privately owned forests,
- supporting measures to complete the cadastre and registration of restituted forest lands,
- strengthening information management systems with respect to forests, and
- taking measures to ensure that protected area management activities are made fully sustainable within a sound institutional and financial framework.

Changes in the NFPS also reflect Romania's strong orientation toward EU processes, and the need to put in place forest management measures which are consistent with initiatives which are to be supported under CAP Pillar 2.

16. The revision of the NFPS provides a good opportunity to consider the scope for reorienting the FDP to be more responsive to the challenges resulting from restitution through restructuring the project and/or reallocating funds across project activities. The mission reviewed these options with MAFRD.

Restructuring and reallocating project funds

17. It was agreed that even in the face of the additional burden of restitution, the original project objectives and design of the FDP remain viable, given the need even more significantly to improve the financial viability of the NFA and to enable private forest owners to manage their forests more effectively.

18. The particular needs which have resulted from restitution include the need to ensure that new forest owners properly demarcate and register their property. This will unleash significant EU funds in support of the management of privately owned forests through the Rural Sector Operational Program under the CAP Pillar 2 window. Box 1 outlines some of the measures and objectives which are planned for support using these resources. Sustained investment is also needed in improving their management capacity, in monitoring forest harvesting on both private and state lands, and in providing regulatory oversight and enforcement.

19. Minister Flutur has several times indicated his Ministry's interest in seeking the Bank's assistance in addressing these additional challenges. It is expected that the proposed Farm Restructuring Project could begin to address the question of the cadastre and titling of private forests which fall within farming landscapes. Some funds from the FDP could be reallocated to address regulatory and private owner management support issues though these are not likely to be more than \$2 to 3 million out of the \$25 million FDP loan.

20. Neither the Farm Restructuring Project nor a reallocation of existing FDP project resources will address, in full, the problem of completing the forest cadastre, though they can provide important catalytic support. At a cost of USD 50 per ha, the planned Farm Restructuring Project, for example, is expected to provide assistance for completing the cadastre on 1.2 million ha of rural forest and non-forest land. Even using more conservative cost estimates of USD 35 per ha for forest land, it would take at least another USD 105 million to complete the cadastre for restituted forests (and around a third of

Box 1: Forestry and the Romania National Rural Development Program

The NRDP establishes the priorities for rural investments under the Common Agricultural Policy. It identifies as specific beneficiaries of the NRDP to include

- Entities involved in agriculture and forestry activities;
- Entities promoting cooperation (associations of producers, water users, forest owners and administrators, groups of producers, NGOs etc.);
- Micro enterprises creating jobs in rural areas, even if not involved in agriculture;
- Processing plants for agriculture and forestry products, for their involvement in the general development of rural areas;
- Agriculture and/or forestry companies using agriculture and/or forest lands, as well as the agriculture and/or forest lands in the Nature 2000 network, where agriculture and forestry works are recommended in order to reach environment-related objectives and maintain landscape diversity;
- Agriculture and/or forestry companies willing to implement environmental protection commitments.

The NRDP identifies two major areas where investments in forestry and forest industries are to be made. The first area broadly describes efforts and investments required to bring about increased competitiveness in agriculture and forestry. The second area describes investments needed to improve the environment in rural areas.

Investments targeted under the first group of activities are to focus on improving the competitiveness of the forestry sector, by creating and upgrading timber processing plants to use modern technologies, the development of forestry infrastructure, and supporting professional forest and forest industry management, mainly by the development of human resources and better training of the forest owners.

Investments targeted under the second group of activities aim to support agricultural and forestry activities in mountainous areas and to support extensive agricultural practices in areas which have high natural and cultural value. These investments are intended to support organic agriculture, preserve traditional agriculture methods, maintain genetic diversity and limit soil erosion and water pollution. Planned activities are mostly related to Natura 2000 sites and other pilot areas which are important for preserving biodiversity, or when there are important landscape features which need to be preserved. Forest protection and management will be supported by measures to strengthen sustainable forest development and the protection of sensitive ecosystems. Other specific measures under this set of activities include support for afforestation of agricultural and non-agricultural land taking into account environment protection, preventing natural disasters and diminishing the effect of climate changes; support for forest management with the objective of developing biodiversity conservation activities and preserving natural sites; and providing support for forest owners which can improve the value of their forests.

this for forests restituted only under the 1991 and 2001 restitution laws). The process is unlikely to be completed quickly, and is likely to be financed by a combination of public and private resources, with partial World Bank financing through the Farm Restructuring Project.

21. MAFRD has indicated its interest in seeking the Bank's support for addressing several specific activities (a) demarcation and registration; (b) improving private forest owners management capacity, including support for expanding the use of voluntary regulatory schemes such as forest certification; and in (c) management, monitoring and enforcement capacity by MAFRD.

22. Three specific proposals have been discussed to accomplish these objectives by reallocating and/or restructuring the Forest Development Project. These include,

- dropping planned support for the Forest Sector Business Information Center (ForsBIC) (budgeted at around \$700,000);
- reallocating all of these funds to expand on-going work with the associations of private forest owners (the ALFO program), in two ways: (i) training and support to enable them to better to sustainably manage forests as well as to prepare projects in order to access the EU agri-environment funds; and (ii) general management support, information and training to enable them to do forest certification.

- seeking supplemental funding, estimated at \$7 to \$10 million, for the development of a forestry GIS layer both for use in developing the forestry cadastre and linked to the Forest Management Information System. This would aid in improving the efficiency of forest management planning, and in improving the information management framework for use by the Forest Inspectorates. Work on this has already been piloted in the national parks, and can be extended to cover much of the rest of the country.
23. Additional proposals have been discussed with MAFRD including the possibility of seeking supplemental support for forest roads and for protected area management, but during subsequent discussions, these proposals were rejected. With the exception of dropping support for ForsBIC, none of these activities would be inconsistent with the objectives and approach which is currently being supported by FDP.
24. The Ministry agreed to develop proposals which are consistent with these themes for further discussion with the Bank, by mid-October. **The mission recommended, and it was agreed that MAFRD would finalize its proposals to reallocate project funds and/or to seek incremental funding by October 20, 2006.** There is some urgency because of the Quarterly Bank-GOR Portfolio Review which is underway.
25. We review performance of each component:

Component 1: Establish Systems to Ensure Sustainable Management of Private Forest Lands

26. This component was designed to provide support to MAFRD's Department of Forests, (a) to increase the capacity of its Forest Inspectorate to supervise, regulate and monitor sustainable forest management; (b) to provide extension and advisory services to private forest owners and to support the establishment and operation of private forest owners associations; and (c) to establish a national Forest Management Information and Monitoring System (FMIMS). Because of the large new number of private forest owners to whom forests are to be restituted, this component becomes increasingly important for ensuring that systems of sustainable forest management are put in place.
27. The first round of procurement of physical assets to assist the Territorial Forest Inspectorates has been completed, providing office furniture and equipment including computers, software, printers, phone and fax machines; field equipment, especially measurement instruments to be used in the field in controlling and monitoring activities; and vehicles to improve the mobility of the Inspectorates. In addition, vehicles have been procured for the National Forest Administration's Service for Protected Areas, to increase the mobility of staff in the park management units in the national and natural parks which NFA is managing under contract to MEWM. The institutional arrangements for the Territorial Inspectorates are still in flux, and further procurement will not proceed until the situation has stabilized. **The mission requested the PMU to prepare a table which outlines the disposition of the vehicles and equipment procured by the project, and to forward this to the Bank by November 30, 2006.**
28. A Human Resources Development plan has been prepared, which outlines training and capacity building needs for the Department of Forests and the Forest Inspectorates. A training plan is in preparation. Capacity building activities which were to receive project support have been significantly delayed, in part because of institutional restructuring and these activities need to be greatly accelerated if the project's capacity building objectives are to be met. **The mission recommended that the training plan for CY 2007 should be**

prepared for review by the Bank by November 15, 2006, on the basis of the HRD plan. The training plan will include proposals for how training specialists are to be recruited.

29. With respect to support for the development of national and local associations of private forest owners, a contract has been entered into to provide services to prepare an approach for supporting the establishment of Associations of Local Forest Owners (ALFOs), for implementing the methodology by establishing at least 10 pilot projects in different areas of the country to assist private forest owners to organize and establish associations of local forest owners (ALFOs), and to put in place measures for bringing about responsible and sustainable forest management by setting up group forest certification schemes for each pilot project. The firm which is carrying out this work has also been contracted to prepare the Strategic Development Plan of the NFA, and important synergies are being developed because of this. A progress report from the firm is due shortly.

30. The field and office equipment for the National Association of Private Forest Owners has been procured and are being used in order to improve its capacity to engage with local forest owners associations. Services to assist the National Association to begin preparation of its own business plan are in the process of being procured. The business plan will cover a 5 year forward plan, and will focus on the development of membership profiles, staffing, a service delivery profile, and financial and cash flow analyses.

31. The mission participated in a workshop to review research findings on the social impacts of forest restitution, convened by the Romanian Academy (Institute of Geography). The workshop highlighted the great diversity of tenure and forest management regimes which are in place, the lack of a commonly accepted terminology for describing non-state forest management institutions, and emphasized the critical role that history and the psychology of memory have played in the interest and willingness of restituted owners to engage in sustainable forest management practices. While private forest owners associations, for example, may be acceptable in some areas, in others, the history of collectivization in Romania has created much skepticism about the potential role of these associations. The mission encouraged the project team to take on board some of these research findings, better to calibrate its approach and to maximize its potential impact. Table 2 describes some of the forest tenure and management regimes revealed by this research. Given the intention to support forest management measures under the Rural Development Program, there should be scope for supporting a range of tenure regimes in improving forest management.

32. With respect to the establishment and development of the Forest Management and Information Monitoring System (FMIMS), three IT specialists were recruited to work with DoF in designing the FMIMS: a project manager, a systems analyst, and a systems designer. The previous mission recommended that the PMU should consider contracting a Forest information management specialist for two to three weeks to review the proposals for design of the FMIMS. Design issues included whether the FMIMS should be web-based or desktop-based; whether the software should be off-the-shelf or designed specifically for the Ministry; the range of the system's functionality (forest management only, or covering the whole value chain); access to the database (Forest Inspectorates only, NFA, MAFRD decision makers, the industry, private forest owners), and so on. A decision was taken by the PMU not to seek this assistance. The design documents were finalized and extensively reviewed before preparing tender documents to procure software and hardware for the FMIMS. The tendering process for this work is in process, and is expected to be completed shortly.

Table 2: Indicative Typologies of Non-state Forest Tenure and Management Institutions			
Name of tenure system	Members	Rights distribution	Forest
Obste	All members of all households in the village (<i>set</i>)	Equally among the members; those who leave the village lose the rights, but regain them on return; not inherited.	Indivisible – specific area cannot be identified as belonging to specific person
Composesorate	All heirs of original members (now > 1000) including those living outside the village	According to number of shares, which are transferable and inherited.	Indivisible – specific area cannot be identified as belong to specific person
Composesorate	All households resident in the village	Equally among the households; outsiders who move to the village also receive shares of wood but do not have voting rights.	Indivisible – specific area cannot be identified as belonging to specific person
Association of individual owners	Heirs of original owners	According to individual ownership	Specific areas owned by specific individuals
Primaria [town hall]	Local government on behalf of constituency	Indivisible; under the control of the elected town council; treated as municipal income used to finance municipal projects	Indivisible – whole forest area belongs to local government
Source: Research reports. Institute of Geography. Romanian Academy			

33. The mission noted that NFA is in the process of designing and procuring a management information system to meet its own business processes and needs (which largely involve handling its commercial needs, including payroll, timber sales, etc.). As this proposal is advancing, it is quite important that attention is given to developing the interface between the NFA's MIS and the FMIMS. This was always an objective, but the PMU now needs to make concerted efforts to establish a framework for working with NFA in doing this.

34. When the FMIMS was originally conceived during project preparation, the intention was to incorporate a strong GIS element to it both to serve the Forest Inspectorates (by enabling the Inspectorates to monitor permitting and management plan processes amongst forest owners, as well as to carry out detailed physical oversight of forest management), but also to provide a framework for the cadastre. The project was significantly scaled-back during Negotiations, and this aspect of the FMIMS was dropped. In conjunction with discussions related to the Farm Restructuring Project, it was agreed that a forest GIS would be extremely useful for the cadastre, and that a discussion about its development should be revived. The Farm Restructuring project team has employed a GIS specialist to assist in developing a more comprehensive view of the scope for developing GIS layers (including a forestry layer), for integrating with Integrated Administration Control System (IACS) and Land Parcel Identification System (LPIS) tasks. This would contribute to the creation of accreditation requirements and improved management of CAP Pillar 2 support measures and area-related payments by compiling and formatting the needed data layers.

35. Further discussions were held by the Farm Restructuring Project team with the Forest Research and Management Institute (Institutul de Cercetari si Amenajari Silvice, ICAS) about its GIS capacities and data availability. It currently holds GIS-compatible data for only around 10 percent of the country (comprising unrestituted state forests), on the basis of forest

management plans which are only updated once every 10 years. It has access to relatively recent partial coverage digital orthophotographs and has a proven capacity to produce high quality forest management plans which incorporate these.

36. The discussion of GIS needs related to forestry highlighted a number of important regulatory opportunities which could be addressed within the scope of the FDP. These relate specifically to the legal and regulatory framework for developing forest management plans for private forests. There are no regulations or guidelines for the collection of digital data when private firms (i.e. not ICAS), prepare forest management plans. It would be a significant contribution if new management plans, regardless of the owners, were required to produce GIS-compatible digital data which could be incorporated into the FMIMS. **The mission recommended that MAFRD's proposals for restructuring and/or incremental support should include pilot activities for developing digital data standards for private forest owners.**

37. In conjunction with implementation of the project's environmental management plan, some preliminary work has been carried out on the use of trade statistics as a diagnostic for determining the incidence of illegal logging in Romania, and on the operation of the timber auction market. Field studies are underway (with USAID support) which seek to identify problems of forest governance amongst private forest owners, and these studies are continuing. Because of the uncertainties which have been introduced because of restitution, and because of the fast pace of institutional change, further governance studies are unlikely to be very useful, at least in the short term.

Component 2: Mitigate the Consequences of Restitution on Management of State Forest Lands

(a) Supporting Reform and Strategic Development of the National Forest Administration

38. This component is designed to assist the National Forest Administration in developing, preparing, and implementing a plan for financing its role in managing State Forests (including protected areas under its management).

39. A contract to provide services for this activity was signed in late January 2006, and this work is underway. The objectives of strategy development are (i) to provide MAFRD and NFA with a detailed, phased and costed plan for the strategic development and future role of NFA with the objective of improving its organizational, operational and commercial efficiency. As an input into the strategy, the exercise is also intended to help identify, quantify and to separate the costs and benefits of the public good and economic functions of NFA, and to prepare recommendations for a financial accounting system to ensure that all activities are adequately resourced; (ii) to provide the NFA with an information systems strategy that will support its strategic development; and (iii) to devise and elaborate an objective and auditable process for determining reserve pricing for timber auctions.

40. Performance of the consultant in meeting these objectives has been mixed. Clearly, a great deal of information has been generated, but there are few outcomes yet available which point to the development of a clear strategy. A number of issues should be noted.

- The development of robust information about NFA's spending on public good and economic functions has been extremely difficult because of the institution's accountancy

practices, and because of the role of the silvic districts as cost centers. The consultant firm has been unable to mobilize the expertise needed to examine in greater depth the complexities of the financial management system to the detail required.

- The consultant can provide good advice to NFA as it develops its information management system, but the preparation of a strategy to do so is out of synch with NFA's immediate business needs – which are being addressed by the design and procurement of a management information system which is already underway.
- A fundamental issue which has emerged from the strategy process relates to the role of NFA on private lands. It currently has a mandate to administer private forests under management agreements with private forest owners (where forest management contracts with private management companies are not already in place), but this generates few revenues and leaves NFA exposed to charges of having a conflict of interest in managing state forests on the one hand, while managing private forests on the other. No one really likes the situation – it doesn't fit NFA's comparative advantage, and private forest owners would prefer that NFA leave them alone. Government needs to take a clear decision about how it wishes to proceed with respect to this particular NFA role, and also to ensure that these lands are properly managed within an appropriate institutional and legal framework.

(b) Rehabilitation and expansion of the forest road network

41. It was envisaged that this component would provide support to develop and test new approaches to road rehabilitation and construction to reduce the negative environmental impacts of such activities and to improve the economic viability of wood harvesting in State-managed production forests. This would be accomplished by: (i) developing and instituting Best Practice Guidelines for forest road rehabilitation and construction; (ii) using these guidelines in project-financed roads rehabilitation and construction to demonstrate how the environmental impacts associated with long skidding distances (and the associated erosion and siltation of water courses) can be reduced; and (iii) showing how roads investments can help improve the overall profit margin by reducing the cost of extraction. No new logging is envisaged to take place because the planned operation is in areas already under active forest management of stands with 100-150 year rotations.

Best Practice Guidelines for Forest Roads Construction and Rehabilitation

42. The project's Environmental Management Plan (EMP) and associated stakeholder consultations recommended and required that the project should finance the preparation of Best Practices Guidelines for Forest Roads Construction and Rehabilitation, which would provide the otherwise missing focus on environmental and social concerns for such operations. The Austrian State Forest Corporation (ÖBF) was contracted to lead the consultation and guideline development process, and held three stakeholder workshops as part of the process involving NGOs, private road building firms, NFA staff, local environmental agencies, and other forest road officials from the key line agencies responsible for road construction or approval. The Best Practice Guideline for Forest Roads was completed, approved by the Ministry of Environment, and signed off on by the Secretary of State for Forestry (of MAFRD) in December, 2005.

43. The workshops and inputs from the Silviculture Faculty at the Transylvania University resulted in the production of two versions of the Guidelines: a short version

(which has been translated into English) and a longer version which includes more detailed descriptions of environmental mitigation measures, such as the revegetation of slopes. The more complete document is being printed as a Transylvania University publication, and initially 100 copies are to be printed. Faculty who have worked on the Guidelines note that this is the first time that such a publication on forest roads has been prepared which incorporates environmental and social safeguard. The mission requested that that second and more complete version also be translated into English as it includes environmental criteria which are missing from the first version.

44. As recommended by the EMP, and agreed during previous missions, the Guidelines are to be widely disseminated, and there will be followup training on their objectives, content and implementation. As a first step in dissemination, the Guidelines have been posted on the project's website (www.forestier.ro). The Mission recommended that the second, more complete version should also be posted on the Ministry's website, accompanied by an explanation about the purpose and evolution of the Guidelines, with provisions for feedback. **It was agreed that the Guidelines would be made available on the Ministry's website by October 30, 2006, and that a draft would remain available for comment until January 31, 2007, after which any necessary revisions would be incorporated into the final version.**

45. In January 2006 the BPG was sent to the County offices of the NFA for information and guidance. The Mission recommended that the second full draft of the BPG should also be sent to each NFA participating branch office (i.e., the ones where there are implementing road rehabilitation subprojects), together with a letter explaining the purpose and content of that Guideline. The BPG was referenced in the roads rehabilitation bidding documents, and its use is a condition of the contract.

46. The EMP also calls for an evaluation of any possible negative social impacts that may be brought about by roads rehabilitation sub-projects. The Ministry already has a public consultation process in place, which involves: (i) publication of an announcements of its intent to do specific works related to forest roads rehabilitation in two national newspapers, in which it solicits public comment or concerns about the proposed road work; and (ii) at the same time, local NFA offices post an announcement, for 30 days, at a prominent place at the Mayor's office, to solicit public comment or concerns about the road works. In the event of any objection, the process is stopped until the concern has been resolved. Once the announcement has been posted for 30 days, the local administration (village committee, local counsel, or municipal government) issues a no-objection letter for the works. This process was carried out in full for the works under this project. During field visits, it was clear that the communities were, if anything, very pleased with the proposed road rehabilitation work, mainly because they depend on those roads for access to their pasture lands.

47. Nevertheless, the NFA sought advice from the Bank about how best to carry out cost-effective public awareness programs during planning and construction phases, to be doubly sure that possible negative social impacts from this activity are identified and mitigated. The mission suggested that such measures could best be developed by a local social scientist with experience in designing and conducting consultation activities. **It was agreed that the PMU will draft TORs for such work and send it to the Bank for comment and further elaboration by November 15, 2006.**

48. As agreed when the project was prepared, plans are underway to convert the BP Guidelines into an official regulation (i.e., a Ministerial Order which would incorporate the additional criteria of the GPG into the existing roads guidelines) so that its application would become a legal obligation for such road building. The Mission agreed that this would be an important step in meeting the intent of the EMP and has recommended that the PMU facilitate this process as much as possible. In the meantime, the Standard Bidding Contracts used for the current project does contain a reference to the need to implement the works in accordance with the BPG (in the "Technical Data of the Project" annex). **The Mission recommended that a separate letter be sent to the contractors by the PMU, pointing out the importance of the BPG and the need to abide by the Guidelines in full. This would be completed by October 15, 2006.**

Status of forest roads construction and rehabilitation activities

49. The first tranche of the rehabilitation program is now underway. Seven contracts were signed in early September 2006 to implement this first tranche for a total contract value of US\$9 million. This tranche will bring about the rehabilitation of 162 km of forest roads in 11 counties and represents around 60% of total Bank financing for the forest roads component.

50. Tendered costs for roads rehabilitation were 75 percent higher than the costs estimated during project preparation. Higher costs are a result of inflation, and an erosion of the US dollars' position with respect to the lei. Given the fact that the original cost estimates date from July 2001, and that the contracts were only finalized 5 years later, this represents an annual cost escalation of around 12 percent. Disbursement estimates for the next year are being calculated, and it is expected that disbursements will spike in around April-May 2007, once the snow pack has melted and the contractors can resume work.

Table 3: Summary of Roads Rehabilitation Contracts (first tranche)							
Contractor/ Roads sub- project	County	Length (km)	Forest area served (ha)	Contract period (months)	Actual Contract value (US\$)	PAD estimated value (US\$)	Difference (US\$)
Contract #1: JAOB—Sociedad de empréstatas							
Nires Vizau	Maramures	11.5	2450	8	424,134	365,978	58,156
Rica	Maramures	14.45	6268	8	681,521	459,859	221,662
Baicu	Maramures	14.7	5330	15	315,833	467,815	-151,982
Contract #2: SC Cornea Ind. Construct Campulug							
Basa fara cale	Prahova	11.3	2778	22	667,139	359,613	307,526
Crasna	Prahova	4.2	730	18	348,139	133,661	214,477
Basca Condrea	Buzau	12.5	3426	20	551,778	397,802	153,976
Contract 3: SC Concifor SA							
Cumpenita	Arges	4.6	2610.8	12	224,409	146,391	78,018
Valea Satului	Arges	6.26	1421.8	12	204,270	199,219	5,051
Runcu Raci	Dambovita	20.2	5091	36	1,639,215	642,848	996,367
Contract # 4: SC DAF Construct							
Carliontu	Timis	3.6	1065.3	20	360,916	114,567	246,349
Axial Barzava	Caras-Severin	8.44	4568.2	16	464,614	268,596	196,018
Valae	Arad	3.95	687.9	8	146,437	125,705	20,732
Milevei	Arad	3.38	488	8	184,784	107,566	77,219

Table 3: Summary of Roads Rehabilitation Contracts (first tranche)							
Contractor/ Roads sub- project	County	Length (km)	Forest area served (ha)	Contract period (months)	Actual Contract value (US\$)	PAD estimated value (US\$)	Difference (US\$)
Contract #5: SC Conferic SRL							
Basca Mare	Buzau	8	12630.1	16	462,340	254,593	207,746
Basca Mica	Buzau	23	11750.5	24	1,530,896	731,956	798,940
Contract #6: SC Batin Impex SRL							
Valea Ruzii	Alba	7.72	984.9	16	432,577	245,683	186,894
Contract #7: SC Interfax Siret							
Coporaia	Bacau	4.5	829.4	14	384,928	143,209	241,719
Totals		162.3			9,023,930	5,165,061	3,858,868

51. Because of higher unit costs for road rehabilitation, the PMU estimates that a total of 270 km of roads (rather than the 425 km as planned in the PAD) will be rehabilitated under this project. Moreover, in view of funding constraints, rehabilitation projects are being given priority over new roads construction. It is expected that no new roads will be constructed (compared with the 10 km which were planned at Appraisal). **This is a very considerable scaling back of the project's original targets.** The remaining 108 km of roads rehabilitation are to be contracted in two tranches of around \$2.5 million each. This, too, is a significant scaling back of activities, as it had originally been envisaged that the roads program would be implemented in 5 tranches.

52. Roads visited by the mission had been severely damaged by recent flooding and one was impassable (Carliontu road in Timis County). Significant work, such as the reconstruction of eroded sections and the installation of drains and culverts is much needed on all roads visited, especially considering the size of the managed forest estate and the maturity of the forests (i.e. access is critically needed for silvicultural treatments or for forests which are ready for harvesting). One major environmental problem, and further justification for this work, is that when roads become impassable, people and harvesting companies tend to use the river bottoms for access, with significant negative environmental impacts.

53. The Mission expressed concern that only one of the contractors had an international profile and that only three foreign firms had tendered bids. The idea of internationally tendering these contracts was based on the hope that foreign firms would be better placed to introduce new, modern techniques of forest road rehabilitation to Romania. Although these contracts were advertised in DG Marketplace and UN Development Business, as well as in the national newspapers, the Mission recommended that greater efforts should be made more widely to publicize the next tranche of rehabilitation.

54. In a number of instances, additional flood damage has taken place since the original rehabilitation activities were designed, increasing the costs of completing planned activities by 5 to 10 percent. The PMU will need to discuss this issue with the Ministry and the NFA to find the best solution. Initially the Mission discussed four possible options: (i) NFA would provide direct financing for the additional works; (ii) the Ministry would provide incremental funding for the sub-project; (iii) planned works would be reduced to a level needed to accommodate the new works (requiring a renegotiation of the contract); or (iv) justify and request a no objection from the Ministry and the Bank for a change in the quantity (and cost) per the agreed provisions in Section 38 of the signed contracts. The PMU, together with the

MAFRD, should estimate the total possible increase on all 17 roads, and compare this with the financing available, and the options for possibly reducing the total number of roads to be rehabilitated, before agreeing to option iv. In fact, option iv is currently the least desirable option from the point of view of programming.

55. The mission also noted various worker safety issues at several of the project sites. While health and safety are referenced in the BPG, there are no specific guidelines in place except those which are already covered by Romanian rules and regulations. Clearly, a lack of training about health and safety issues should be addressed, and the Mission recommended that health and safety issues should be closely monitored by the Supervision and Monitoring team, and in particular by the periodic PMU site visits. The Mission also recommended that ISO provisions for worker safety should be adopted and that these procedures be covered in planned BPG training) and that over time it would be good to include ISO Certification as a selection criteria for under any future Bank-financed road works. While the Mission recognizes that few, if any, Romanian forest road contractors are ISO certified, this should be a goal for developing best practices in forest road construction.

Preparation for the next tranches of roads rehabilitation

56. Feasibility studies and the technical specifications for the tranche of the roads rehabilitation sub-projects have already been commission and are nearly completed. Given the advanced progress in designing the technical specifications of the remaining roads, the PIU estimates that the final 100 km or so of roads works can be contracted with confidence and quality over the next 6-7 months, probably in two separate tranches. Hence the preparation of tender documents for the second tranche of about 50 km of road, with a value of about US\$2.5 million, is now underway. The third and final tranche of another US\$2.5 million will follow soon after the second tranche has been tendered, and the tendering process for the final package is expected to be completed by about May 2007. The main reason for dividing the remaining packages into two tranches is to provide an opportunity for improving the tendering process with lessons learned from the first two tranches. The second and third package may also offer opportunities to interest a wider scope of bidders, including those with an international profile.

Roads contract supervision and monitoring

57. The mission discussed planned supervision and monitoring of roads works with the MAFRD, NFA and PIU and it was agreed that oversight would take the following form:

- NFA has contracted or appointed 10 Site Managers to oversee the 17 road projects. By Romanian law, any entity that commissions the construction or rehabilitation of a road must hire a "Site Manager", who is an experienced and licensed civil engineer responsible for day-to-day supervision of the technical and environmental quality of the contractor's work. Contractually, the PMU is mandated to supervise the quality of the works, but will formally delegate day-to-day supervision to the NFA branch offices. The mission recommended that formal delegation should be completed, by written agreement between the PMU and the NFA as soon as possible, and set a target date of November 30, 2006. The PMU will also reiterate the contractual requirement that firms adhere to the BPG.
- The PMU will carry out periodic (i.e., quarterly) supervision visits to each road site during the construction phase to ensure that the provisions of the BPG are being taken into consideration.

- The Forest Inspectorates have responsibility for monitoring the quality of completed works, including the environmental screening and review. Seven of the nine ITRSV offices will be responsible for overseeing the first tranche road rehabilitation work. Inspections are made about once a month as well as at key construction points.
- Regional offices of MEWM have responsibility for monitoring environmental impacts of the works and will visit the sites at critical times. The local offices of the Ministry of Environment have also already carried out environmental reviews and screening of each of the seven contracts, prior to signing.

58. Contract performance is ultimately evaluated by a committee comprised of representatives from the municipal administration; the local branch of the Ministry of Environment; the local Branch of the Ministry of Water; the Forest Inspectorate; the Ministry of Defense, and the Construction Ministry. A 10% retainer is held back and paid to the contractor only after all committee members approve of the final works.

59. **The Mission recommended, and it was agreed, that training in the BPG would be provided for the Supervision and Monitoring Team.** Initially this training should include the 10 Site Managers, the 7 Forest Inspectors (ITRSV) from the related counties, the 7 local representative of the Ministry of Environment and the 2-3 roads engineers from MAFRD and NFA assigned to oversee this activity. It was agreed that the PMU could best conduct this training, with possible help from the Silviculture Faculty in Brasov, and that this could be carried out during the winter months. **It was agreed that the PMU would develop training material by November 30, 2006 and would organize and conduct the training by mid-January 2007.**

60. The primary impact of the roads rehabilitation component is an economic one: to reduce the costs of harvesting and extraction, thus ensuring that NFA receives a higher value for standing timber in auction markets. There are various indicators that could be measured before and after road rehabilitation to assess the development impact of this project component, namely: (i) extraction costs; (ii) auction prices for standing timber; (iii) fuel and maintenance costs for extraction; (iv) total number of bidders (i.e., on the damaged Valea Ruzii road there were only two bidders at the last auction rather than the usual 7-8 when road conditions were good). **The PMU will, by end October 2006, draft key indicators for this activity and will send these to the Bank for comment and further elaboration.** As soon as those key indicators are finalized, the PMU will send a letter to all participating NFA offices requesting that they send the relevant before-project data. These indicators will be incorporated into the overall monitoring system.

61. Because of the importance given to improving social and environmental performance in implementing forest roads rehabilitation activities, the mission recommended that the PMU should contract a separate environmental performance monitoring activity to provide an additional degree of environmental oversight during roads contract implementation. The outcome would greatly assist in preparing the subsequent tender packages, for ensuring that environmental issues are fully taken account of during the tendering process. **The PMU will prepare TORs for this activity, for review by the Bank, by December 15, 2006.**

Component 3: Support Increased Productivity and Competitiveness of Forest Industries

62. This component provides resources for establishing the Forest Sector Business Information Center (ForsBIC), an independent business development and advisory service, to

establish linkages and coordination within the forest industry chain (i.e., silviculture, harvesting, transport, primary and secondary processing), and to provide assistance to wood and related forest industries, through review and dissemination of information on new technologies, markets and prices, export and hygiene requirements, product promotion and branding, opportunities for joint venture partnerships, and the availability of grants, and credit, etc.

63. As noted during the previous supervision mission, there are a number of questions about the relevance of this particular activity. When the project was originally designed, the rationale was clear. But since then, restitution and the substantial private sector investment in the processing industry has limited the need for the support services which had been originally envisaged. To some extent, these are already being provided by the private sector. During the previous mission, it was agreed, that further action on this component should be delayed until the clear need for particular services could be clarified.

64. Discussions with MAFRD confirmed that, given the private sector's role in already providing the types of services envisaged for the ForsBIC, the usefulness of this particular component has been greatly diminished and is far less of a priority than tackling more substantive issues related to restitution. Consequently, it is expected that the Ministry will propose to reallocate funds originally targeted for this component to other project activities related to the development of local associations of private forest owners.

Component 4: Building Public Support for Sustainable Forest Management

65. This component provides resource for preparing and implementing a public awareness strategy and campaign and for targeting key stakeholders including the general public, with particular emphasis on communities living in forested areas; private forest owners; the forest industry; Forest Inspectorate staff; NFA; Government decision makers, and other influential groups including the churches and NGOs.

66. This component has been entirely contracted out to a Public Relations firm with the task of implementing the public awareness strategy for the forestry sector, including public relations support, information and education for various target groups. The Mission reviewed the progress reports prepared (which are pending revision and approval from MAFRD), and made the following recommendations:

- The objectives of the campaign should be more fully linked to the development objective of FDP – i.e., to increase the contribution to the national economy of sustainable forest management. The currently proposed campaign – to raise awareness of the public about the effects of the massive illegal forest cutting, adds to the hysteria created by the press on this topic, is too narrow and only partly contributes to the project's development objective.
- There is significant scope for creating more positive and appealing messages to induce and create incentives for behavioral changes leading to the adoption of sustainable forest management practices. Messages should focus on success stories with private owners and communities which found ways to both benefit from and live in harmony with their forests. The proposed slogan of the campaign could be more innovative and imaginative, rather than resembling a sentence in a biology text book, or the old forest district banners.

- Target groups for both awareness and education should also include stakeholders who have close contact with communities and forest owners, who are opinion leaders and have credibility. These include the church, mayors, regional associations of private forest owners, the district forest inspectorates, parks management and even the local NFA staff. Awareness and education could also target children and teachers in schools, with new curricula and hands-on learning during field days. The communication vehicles and techniques, besides the traditional ones (TV, newspapers, brochures, posters), could also include non-traditional channels, which are more appropriate for rural communities.

67. Related to this contract is the need to greatly improve the public availability of project information, to comply with the recommendations of environmental management plan. The project website has been updated to report on current project progress, but needs to be more consistently maintained in a way which captures the overall messages of the PA program.

68. There is also a need to make a closer connection between this component and activities related to the establishment of private forest owners associations. The PMU has indicated its intention to facilitate the work of the PA consultants with the ALFO consultants to help increase the impacts of both campaigns.

Component 5: Project Management and Monitoring

69. This component provides support for the Project Management Unit to assist with supporting implementation of all project activities. The PMU is in place, and its functions have been formally authorized by the Ministry. The PMU comprises a Team Leader, two technical specialists (road and public awareness), a procurement officer, a financial management specialist and assistant. A Deputy Team Leader has been in place since early September 2006.

70. The previous mission noted that PMU staff turnover was hindering project performance (with the departure of the Financial Management Specialist, the roads procurement specialist, and the procurement specialist). New staff have been recruited to fill these positions, and a Deputy Team Leader has also been recruited. The PMU has gained a new level of stability as various project activities are moving forward.

71. A Monitoring and Evaluation framework, consistent with the key performance indicators and the logframe in the PAD, has been prepared and is being refined. The mission provided detailed comments on this framework.

72. In October 2006 Bogdan Constantinescu, Senior Financial Management Specialist, carried a financial management supervision mission of the Forestry Development Project (FDP), with special attention to financial management and disbursement issues. The following areas of the project financial management were examined: project accounting and reporting arrangements; internal control procedures; planning and budgeting; counterpart funding; disbursement; financial manual; external audits; review progress since last supervision, if any, and organization and accounting staff. The mission's findings and action plan are presented as Annex 2 at the Aide Memoire.

73. The mission noted its concerns about project oversight. When the project was conceived, it was envisaged that a Project Oversight Committee would be established. While such a committee has been constituted by the Ministry, it has not formally met. Despite earlier assurances that the Project Oversight Committee, including civil society and private

forest owners representatives, would convene to review project progress, this has not happened. The POC, which is required by the Loan Agreement,² was meant to provide a platform for Government stakeholders, as well as civil society representatives, and private forest owners associations to convey their views about project performance and to broaden the discussion about forest policy. The failure effectively to operate this mechanism is a serious constraint to project performance.

Issues Requiring Special Attention

74. The primary issue which should be addressed relates determining if and how the Ministry wishes to restructure and/or reallocate project funds.
75. The Bank and Government will also need to agree on a timetable for carrying out the Midterm Review, which is likely to be in the first quarter of CY 2007. The MTR will depend critically on monitoring and evaluation reporting, which should be assembled by the PMU well before the planned mission, as well as other regular progress reporting.
76. The momentum on the forest roads component needs to be maintained, and attention needs to be given to finalizing tender documents for the second tranche. Further steps are needed to ensure the Best Practice Guidelines are made fully effective as part of on-going contracts, and that staff are fully trained to ensure that they are used correctly.
77. The program of training for CY2007, geared toward improving the capacity of the Forest Inspectorates and the DOF, needs to be prepared and agreed with the Bank.
78. Finally, clear action needs to be taken to make the Project Oversight Committee more useful and functional, and in the spirit of the Loan Agreement.

² The LA states that the POC is to be comprised of “DOF, MAFF, Ministry of Public Finance, and civil society representatives, which shall provide oversight and policy guidance for Project implementation.”

Annex 1

**ROMANIA FOREST DEVELOPMENT PROJECT
AGREED PRIORITY ACTIONS – SEPTEMBER 2006**

Component/Task	Responsible Party(ies)	Timeframe	Remarks
<i>Component 1: Establish Systems to Ensure Sustainable Management of Private Forest Lands</i>			
Complete table outlining disposition of project-financed vehicles and equipment	PMU	November 30, 2006	Forward to Bank
Complete training plan for CY2007	PMU	November 15, 2006	Forward for review and NOB to Bank Should include proposals for how to procure
<i>2. Component 2: Mitigate the Consequences of Restitution on Management of State Forest Lands</i>			
Post Best Practice Guidelines (BPG) (long version) on Ministry and project website	PMU and MAFRD	October 30, 2006	Leave available for comment until January 31, 2007
Prepare TORs for activity to increase local awareness of roads activities	PMU	November 15, 2006	
Send correspondence to roads contractor reminding them of their contractual obligations to follow the BPG	PMU	October 15, 2006	
Prepare training activities in implementation of BPG	PMU	Training material prepared by November 30, 2006 Training provided by end-January 2007	
Prepare TORs for environmental/social impact monitoring and oversight	PMU	December 15, 2006	Consultant should be in place well before construction starts up after the winter
Prepare tender documents for the Bank's review and NOB for second tranche of roads rehabilitation activities	Roads and Procurement Specialists	Mid-January 2007	
<i>Component 3: Support Increased Productivity and Competitiveness of Forest Industries.</i>			
Decide whether or not this component is going to be dropped	Ministry	October 30, 2006	
<i>Component 4: Building Public Support for Sustainable Forest Management</i>			
Revise inception report to take account of feedback received	Consultant firm		
<i>Component 5: Project Management and Monitoring</i>			
Finalize Monitoring and Evaluation framework	PMU with consultant inputs	November 30, 2006	
Prepare proposals for reallocation and restructuring	Ministry with PMU	October 20, 2006	Need to coordinate with Bank/GOR Joint Portfolio Review

Annex 2

Forestry Development Project (P067367)

Financial Management Supervision Mission – October 2006

A. Background and Scope.

1. Bogdan Constantinescu, Senior Financial Management Specialist, met with representatives of the Project Management Unit (PMU) established within the Ministry of Agriculture, Forestry and Rural Development (MAFRD) in Bucharest, to carry out the regular financial management supervision mission of the Forestry Development Project (FDP), with special attention to financial management and disbursement issues.
2. The mission examined the following areas of the project financial management, including: project accounting and reporting arrangements; internal control procedures; planning and budgeting; counterpart funding; disbursement; financial manual; external audits; review progress since last supervision, if any, and organization and accounting staff.
3. The previous supervision report is dated July 2005.

B. Executive summary.

4. The following areas of the project financial management were reviewed, including project accounting and reporting arrangements, staffing, internal control procedures, planning and budgeting, counterpart funding, financial manual and external audits. The financial management arrangements of the project continued to be satisfactory and the control procedures are in place. The accounting software used by the PMU has adequate security levels and its outputs are used to prepare quarterly financial monitoring reports (FMRs) of the project and the previous delays and errors in the FMRs' submission, caused by the updates in the accounting software, seem to have now been corrected.

C. Proposed ISR Ratings.

4. In accordance with the ISR Guidelines, the following financial ratings are provided below:

<i>Key ISR Indicator</i>	<i>Rating</i>
Financial Management Supervision	Satisfactory
Counterpart Funding	Satisfactory

D. FM Risk Rating.

5. FM Risk Rating has been updated in ECA Risk and Portfolio Management System (RAPMAN). Based on the current FM supervision, the project FM risk is rated at substantial risk, and the residual risk remains within acceptable level (20% limit.).

E. Financial Management Review.

6. Organization of the PMU and Staffing. The financial management aspects of the Forestry Development Project are managed by the PMU, established within the Ministry of Agriculture, Forestry and Rural Development (MAFRD). The PMU reports to the MAFRD Minister and to the Ministry of Public Finance (MoPF). The PMU's financial management and accounting functions are covered by the finance manager, overall responsible for the project's financial management and the

accountant. The finance manager and the accountant have attended the joint disbursement and financial management workshop organized in early June 2006 by the World Bank in Zagreb.

7. Project accounting system and reporting. All records under the project are kept in the existing accounting software, AXL, which has been recently updated, including the new chart of accounts. The PMU financial manager verifies all accounting transactions in the software entered by the PMU accountant and prepares a monthly trial balance and other reports requested by the MAFRD and MoPF. The system ensures the preparation of the quarterly financial reports.

The back up of accounting information is done daily and the back up is stored on another computer.

The PMU has prepared and submitted the quarterly FMRs, but with some delays and errors mainly caused by the updates in the accounting software. This situation seems to have now been corrected, with the most recent quarterly Financial Monitoring Reports (FMRs), for the quarter ended September 30, 2006 submitted on October 25th, 2006. The FMRs are generally in line with the formats agreed at negotiations, except for the physical progress reports (output monitoring reports) and procurement reports which have not yet been prepared. *It has been agreed with the PMU that, starting with the quarter ended December 31, 2006, the physical progress and procurement reports will also be prepared as part of the quarterly FMRs in line with the formats agreed at negotiations.*

8. Internal Controls. The PMU has adequate internal controls for the project, including regular reconciliation of bank accounts, adequate segregation of duties and performs monthly reconciliation of disbursement summaries of the World Bank with project accounting records. The PMU uses a set of accounting policies and internal control procedures in accordance with the Romanian legislation and the project financial management manual.

There are several layers of control related to the approval of each contract and then of each invoice and payments. The contracts are reviewed internally by the various PMU experts, from the technical, legal, economic and procurement angles. All contracts are reviewed also by the MAFRD relevant departments. Once the contracts are signed for an approved activity, the PMU financial manager starts monitoring the payment schedule, while the other experts monitor the technical implementation.

When an invoice is received, the PMU financial manager informs the other PMU members and obtains the internal authorizations for processing, including from the procurement specialist, from the coordinator in regard of technical aspects and the ex ante control from the MoPF's controller delegated to MAFRD. The PMU accountant prepares the payment documentation in respect of the loan eligible percentage and also for the Government co-financing, so that both happen simultaneously. The payment orders are signed by the PMU director after having been checked by the financial manager and the other internal verifications.

The PMU director's business trips abroad are reviewed and approved by the MAFRD Minister. However, all other PMU director's expenses (such as trips within Romania) are reviewed internally by the PMU staff and approved by the PMU director. *As a matter of good practice and to avoid any conflict of interest, it has been agreed that all the PMU director's expenses will be approved by the MAFRD Minister or by another high level MAFRD official designated by the Minister.*

The PMU uses the petty cash for cash payments, such as travel advances and other small operational expenditures. The daily closing balance of the petty cash is kept within the agreed limits (the largest closing balance in the period was about RON 5,000, ie around \$ 1,800). A safe is used by the PMU.

The PMU has accessed regularly the client connection system, however the monthly reconciliation is not documented consistently. *It has been agreed that the PMU financial manager extracts from the client connection system the monthly disbursement summaries and each withdrawal application details, performs the reconciliation monthly in a timely manner and documents appropriately the reconciliation done with the client connection system, starting with September 2006.*

9. Funds Flow and Disbursement. The project continues to have adequate fund flow and disbursement arrangements. The project is disbursing on traditional disbursement techniques (SOE). The Special Account in US\$ and the other project account in RON are opened at Citibank Romania, a commercial bank acceptable to the Bank.

By October 25, 2006, only an amount of \$ 2.17 mn., has been disbursed, representing 8.68% of the \$ 25 mn. loan. The latest withdrawal application, amounting to \$ 0.434 mn., is currently processed.

Co-financing and Counterpart funding: The Government contributed to the project in the percentages agreed in the legal agreement. The PMU requests and receives from the Treasury the counterpart funding for the relevant disbursement categories and taxes, with no major delay.

10. Asset register. The PMU keeps project fixed assets and petty inventories' basic records and calculates the monthly depreciation per the law. The PMU performs the detailed full fixed assets reconciliation yearly and the first yearly reconciliation, finalized before December 31, 2005, did not reveal any irregularities. However, the fixed assets and petty inventories registers are not kept up to date, there are no records updated since December 31, 2005, the fixed assets register records require updates in respect of the person responsible for the fixed asset and there are no inventory numbers tags placed on the fixed assets. *It has been agreed that the fixed assets registers, records and tags will be updated by November 30, 2006.*

11. Budgeting. The PMU prepares an annual business plan for the project, which is sent for approval to the MAFRD Minister and then to the MoPF, as part of the overall MAFRD budget. For 2007, the requested amounts (loan and Government) have been included in the budget law.

12. Financial Manual. The PMU has in place a financial management and accounting procedures manual for the project, but which has not been updated since 2005. *It has been agreed that the PMU will update the financial manual before the end of 2006 and yearly thereafter.*

13. Audits. The project financial statements for the year ended December 31, 2005 have been audited by independent auditors, based on terms of reference acceptable to the Bank. The auditors (PwC) have issued the audit reports in early July 2006 with a clean audit opinion and have mentioned two internal control issues in the management letter which have been subsequently addressed by the PMU. The audit contract signed with PwC covers the entire project life, subject to annual satisfactory performance, and it is planned that the FY 2006 audit work will be started in early 2007.

14. Transaction Review. The objective is to ensure existence of valid internal controls over disbursement from loan funds and to check that adequate supporting documentation is available, the expenditures are eligible, the appropriate percentages have been applied and actions have been taken in respect of ineligible expenditures claimed, through walkthrough reviews of key controls. The walkthrough review confirms that the internal control exists in the transaction processing. Overall internal controls while preparing withdrawal application is adequate, the required supporting documentation is in place, properly checked and authorized for payment by respective staff, the correct percentages and exchange rates have been used.

F. Action Plan.

15. There are a number of actions agreed upon, which will be dealt with by the PMU as follows:
- a) Starting with the quarter ending December 31, 2006, the PMU will also prepare the physical progress reports as part of the quarterly FMRs in line with the formats agreed at negotiations;
 - b) All the PMU director's expenses will be approved by the MAFRD Minister or by another high level MAFRD official designated by the Minister;
 - c) The PMU financial manager extracts from the client connection system the monthly disbursement summaries and each withdrawal application details, performs the reconciliation monthly in a timely manner and documents appropriately the reconciliation done with the client connection system, starting with September 2006;
 - d) The fixed assets registers, records and tags will be updated by November 30, 2006;
 - e) The PMU will update the financial manual before the end of 2006 and yearly thereafter.