

06.05.2015

GM/IA/WF/2/2015(a)

GCEO

### **LTE PROJECT IMPLEMENTATION**

This further refers to the audit report submitted on 24.3.2015 with regard to the above matter. Consequent to the said report and as per directions given by you, further clarifications & explanations were obtained from respective officers and the final report is submitted accordingly.

#### **Project Management Team**

1. Mr. Mahinda Herath – Project Sponsor
2. Mr. K.T.C. Jayawardana – Project Manager & Chairman/TET
3. Mr. Laksman Perera – Program Manager

#### **Background**

Under phase 1, 2 & 3 of ABP 2013 & 2014, it was designed to commissioned 1,808 Nos of eNodeB at 365 locations with the coverage of 2km radius from each eNodeB.

The main objective of the above tender is to design, supply & implementation of LTE network in turnkey basis and the initial estimated cost of the project was of Rs. 4.2bn and initially POC was conducted with prominent suppliers due to knowledge gap of technical knowhow of SLT staff thereby in terms of outcome of POC, the three suppliers (Alcatel, Huawei & ZTE) were selected for issuing of RFP.

With regard to the complaint made by one of the shareholder of SLT on 13.10.2014 to the Chairman/SLT, Audit Committee had advised to appoint KPMG to carry out an independent review of the process of the above tender thereby they have submitted their report to the Chairman Audit Committee on 14.11.2014 along with their findings. Further, under Para no 6 of the report, it is stated that at the meeting held with the management on 24.10.2014 & 27.10.2014, it was informed that M/s Huawei was disqualified from technical evaluation due to obtaining least technical marks/ranking & unethical practices carried out by M/s Huawei. Further it is stated that a presentation had been prepared by TET & SCET to the Board of Directors whereas due to time constraint, the presentation was not made.

#### **Evaluation Process**

The TET was appointed (Comprised of 12 members including Chairman) for technical evaluation which was approved by then GCEO thereby the evaluation was carried out in terms of the predetermined evaluation criteria and the report was submitted to Chairman/SCET on 28.3.2014 recommending two suppliers of Alcatel & ZTE on the basis of technical compliances for commercial evaluation.

However, the technical bid of Huawei was turned down due to the deficiencies encountered during the course of drive test. Subsequently, the project sponsor had informed to the Chairman TET & CET on 16.4.2014 to reconsider the commercial evaluation of Huawei in terms of the directions given by STB and further he had recommended to then GCEO obtaining the service of an independent consultant (Mr. Mahoda Gamage) for test environment & sign off the test results by paying of Rs. 40,000 which was approved by then GCEO on 21.4.2014.

The drive tests of all suppliers & work shop on capacity Vs. coverage (range) were carried out with facilitation of the above consultant and the report was submitted to the project sponsor on 29.4.2014 accordingly.

The following SCET was appointed on the approval of then GCEO on 24.3.2014 due to volume of normal CET was overloaded with other commercial evaluations.

Mr. Udeni Samarathna	- CFO	Chairman
Mr. Upali Mahamithawa	- GM/FP & IR	Member
Mrs. Harshanee Wijerathna	- Com.Contract	Member
Mr. Thusara Jayawardana	- DGM/IP & ISP	Chairman/TET
Mr. M.B. Herath	- CEO/Sky net	Sponsor

The TET report was submitted to DCAO on 28.3.2014 recommending opening the commercial bids of M/s Alcatel & ZTE and subsequently, project sponsor had requested from Chairman/SECT on 16.4.2014 to consider the commercial evaluation of M/s Huawei on the instructions given by STB.

At the meeting held on 4.6.2014 with then GCEO and SECT team, project sponsor had suggested the following proposals to be implemented and discussed the outcome of the repeat test drive results

- (a) To remove the existing project Manager (Chairman/TET) and to replace with another member.
- (b) To change the evaluation methodology

#### **Evaluation Methodology proposed by Project Sponsor**

The following evaluation methodology & criteria was suggested by the project sponsor at the said meeting held on 4.6.2014 on which date the technical & commercial bids were opened.

1. The weight of technical & commercial evaluation marks 60% & 40 respectively.
2. Technical evaluation marks
 

- 40% For technical evaluation	}	60%
- 10% For Coverage distance		
- 10% For Presentation		
- 35% For price bid	}	40%
- 5% For stability of bidder		

3. As per the direction of STB dated 11.2.2014,

- There should be a minimum of two suppliers to be recommended for all items other than sole source items.
- Every attempt should be made to get the second lowest supplier to match the prices of the lowest supplier.
  - (a) If matched, the total scope shall be divided 60: 40 basis between lowest & second lowest.
  - (b) If not matched, the ratio shall be 70 : 30

#### **Approval of STB & Board of Directors**

The final SCET report was submitted to STB on 5.9.2014 recommending to awarding the contract on the basis of 30% & 70% to M/s Huawei & M/S ZTE respectively to the value of USD 57,533,017.35 (Huawei USD 18,718,593.92 & ZTE USD 38,814,423.43) which is the lowest (option 1) out of three options. The number of eNodeB to be supplied by M/s Huawei & M/s ZTE under the above ratio is 466 & 1,089 respectively.

The STB had granted the approval on 25.9.2014 and which was approved by the Board of directors on 26.9.2014 with the following conditions.

- (a) Each supplier should be requested to confirm the supply of fixed LTE CPE's to the value of USD 1.0mn free of charge(FOC)
- (b) The total value of CPE offered FOC would be gauged by SLT using benchmarked prices in the world market & offered to other parties.
- (c) The confirmation & commitment for the above should reach SLT procurement division on or before 27.9.2014

However, M/s Huawei had turned down to accept the contract thereby on the recommendation of STB of 22.1.2015 board had granted the approval on 23.1.2015 to award the contract to M/s Alcatel at the same price (USD 18,718,589.99) awarded to M/s Huawei.

#### **Audit Findings**

##### **1. Absence of Reviewing of Market Share**

During the course of technical evaluation, the market shares of vendors was not reviewed & assess in order to determine the successes stories behind their deployment of TD-LTE network experience. It revealed that SLT technical team had not adequate technical knowhow of TD-LTE deployment thereby it has become part & parcel to review the market share of the vendors & the overall view of global operators who had deployed TD-LTE network initially which had been adversely affected to the selection process of vendors for TD-LTE network implementation. Market share of vendors in LTE network is attached under annexure No 1.



## **2. Absence of proper approval for appointing SCET**

In terms of Terms of Reference (TOR) Commercial Evaluation Team (CET), (Provision No 2.6 of TOR) the Special CET (SCET) to be appointed by Senior Tender Board (STB) on the recommendation of GCEO whereas the said guideline was not followed thereby it was appointed by then GCEO. So that, it appears that the appointed SCET was not empowered to evaluate the commercial bids.

Further, as per the approval of then GCEO, the SCET is comprised of four members (CFO, GM/FP& IR, DGM/Legal commercial contract & DGM/IP & ISP NW PI who is the member and as the Project Manager) whereas the project sponsor also had signed the commercial evaluation report who is not the authorized member of SCET submitted to STB on 5.9.2014.

## **3. Change of evaluation criteria defined by TET**

- (a) The technical & commercial evaluation(TET&SCET) criteria was changed on the recommendation of project sponsor after opening of technical & commercial bids as per the meeting held on 4.6.2014 which was chaired by then GCEO.

In terms of procurement guideline & the practice of the company, it is violated the fundamental requirement of procurement guidelines. Further, the evaluation criteria were published to the suppliers with the Request for Proposal (RFP) thereby subsequent changes leads to take place litigation against SLT.

- (b) Even though, project sponsor has stated that the approval from STB & TSC was obtained, he had not submitted such approval so far and at the meeting held with GCEO on 22.4.2015, he was advised to submit the said approval whereas it was not received. Therefore, this should be considered as a serious tender procedure violation.
- (c) In terms of proposed technical criteria 60% marks allocated were split into three criteria thereby 40% for technical, 10% for distance coverage in 2km and other 10% for presentation. This change was done after submission of technical evaluation report of 28.3.2014 and the marks allocation (10%) for presentation is appeared as no substance and the coverage distance of 2km is an important technical parameter which was allocated similar marks of 10% which determines the number of base stations. However, it is suggested to obtain technical clarification from relevant source.
- (d) Out of 40% marks allocated for commercial evaluation, 35% marks were assigned for NPV commercial price of the supplier thereby the proposed formula had interpreted that if bid is 25% or more than the lowest bid, that highest bid is become zero marks and lowest will receive the full 35%. This appears to be a baseless ranking process which was never practice in SLT. Further, it appears that this price formula was introduced with a view to reject M/s Alcatel who had quoted highest price which would have negotiated.

The attached evaluation summary No 2 is self-explanatory.

- (e) The remaining 5% of commercial evaluation was assigned to stability & standing of the bidders which is also a baseless ranking process under which M/s Alcatel was given least marks. In order to determine the stability of bidder it is required to assess & review the market share, financial status of the bidders which was not performed.

#### **4. Incorporation of subsequent prices of ZTE**

- (a) SLT had a meeting with the Huawei & ZTE on 13.6.2014 for price clarification and they were requested to submit their prices as to the clarifications thereby they had submitted the prices on 16.6.2014 whereas Alcatel was not summoned for the meeting.
- (b) As per the Para no 2.1 of the SCET report, it is stated that for the purpose of final evaluation, the prices received up to 30.4.2014 were considered whereas the prices for missing items of USD 8,800,791.01 submitted by M/s ZTE on 16.6.2014 were incorporated to the final evaluation whilst the prices submitted by M/s Huawei on the same day were not considered for evaluation. In terms of SLT tender procedure this is also a major violation of tender procedure. A copy of price clarifications of ZTE & Huawei is attached under annexure no 3.

#### **5. Absence of price quotations of vendors for adjusted BOQ**

Initially, tender was called on the basis of number of required BTS to cover 365 locations of 2km radius to fulfill the required coverage thereby the vendors site scope of eNodeB was of Alcatel 1,808, Huawei 2,000 & ZTE 2,298. Subsequently, during the course of commercial evaluation, SECT has stated that on the guideline & the approval granted by TSC on 29.8.2014, SCET had concluded to deploy 1,555 no of eNodeB during three years period whereas in terms of CET TOR it does not come under the purview of SCET and it should be referred to TET for assess & evaluation as to the proposed BOQ.

The approval granted by TSC/STB with reference to the above process was not available for our verification and even GCEO advised to project sponsor on 22.4.2015 to provide the said approval whereas it was not provided.

However, SECT has calculated the prices of 1,555 eNodeB on pro-rata basis on the price quoted by the vendors on 28.3.2014 for the initial quantities stated above whereas the fresh prices were not called for the 1555 Nos of eNodeB. Since the vendor have quoted prices for the different BOQ it is prudent to call price for proposed BOQ. Therefore, in terms of tender guideline, it is required to call for fresh price quotations from all qualified vendors for commercial evaluation thereby it has been violated the tender conditions.



## 6. Price calculation for final BOQ

During the course of reviewing the basis of pro-rata price calculations against variable units of three vendors which was submitted on 30.4.2014, it appeared that the price calculations of each vendor was done adopting different methods thereby it was observed that there is no visibility & integrity maintained to calculate the pro-rata price of the vendors for 1555 eNodeB.

Therefore, the pro-rata price calculations for 1555 eNodeB performed by SCET & auditors are stated below.

- (a) As per RFP, SLT has requested 90 concurrent user licenses from the vendors thereby Huawei eNodeB prices is of USD 8.75Mn whereas the price calculation of SECT is of USD 14.65Mn which appears to be higher amount of licenses thereby no evidence available as to the consent of the vendor. As a result, the quoted price was increased by USD 5.94Mn.
- (b) The local goods prices of ZTE which was submitted subsequently were calculated by auditors on pro-rata basis which is amounted to USD 7,569,264.39 whereas that of SCET calculation was amounted to USD 7,669,046.11 thereby the excessive amount is USD 99,781.72.  
Further, SCET has calculated the unit rate of eNodeB of ZTE at the rate of USD 26,155.09 which is incorrect whereas the correct unit price as per audit was of USD 26,579.81 thereby total price difference of 1555 units is  $(1555 \times 424.72)$  USD 660,439.6
- (c) The price calculation as per the audit, the above value of USD 7,569,264.39 which was subsequently submitted was eliminated.

Therefore net effect to the ZTE price is  $(660,439.60 - 99,781.72 = 560,657.88)$  USD -560,657.24  
 $+ 7,569,264.39 = 7,008,607.15$

Supplier	Prices as per SCET (USD)	Prices as per Audit (USD)	Difference (USD)
Alcatel	76,969,514.61	-	-
Huawei	63,834,607.28	57,887,428.02	5,947,179.26
ZTE	56,163,379.58	49,154,772.43	7,008,607.15

## 7. Deviation from CET TOR

Several instances were observed where SECT has violated the fundamental provisions of SCET TOR, thereby SECT had unlawfully assessed & evaluated the technical phenomenal which do not come under purview of SCET which are to be evaluated by TET.

The instances are stated below.

- (a) SECT report no 1.2 – Recommendation to obtain further services of independent consultant
- (b) SCET report no 1.3 – Drive test results, outcome of the capacity vs. coverage workshop and recommendations of the independent consultant.
- (c) SECT report no 1.4 – Overall marks for the presentations made by bidders
- (d) SCET report no 1.5 - Equal number of eNodeB

## **8. Minutes of the Meeting of Board of Directors held on 26.9.2014**

While approving the recommendations of STB at the board meeting held on the above date, it is stated that two bidders should be requested to provide confirmation before 27.9.2014 to supply fixed LTE CPE's to the value of USD 1.0Mn on Free of Charge.

Further, it is stated that SLT needs to gauge the CPE's using benchmarked prices in the world market or offered to other parties. During the audit review, it revealed that the category of CPE's was not mentioned in the board decision.

### **Responses received from SCET**

Audit queries were called from SCET for major audit findings mentioned above and the responses received against each issue is stated below under each above reference.

#### **(a) Change of evaluation criteria defined by TET (Audit Finding No 3)**

As per the responses of SCET, it has been saved USD 32.2Mn since the evaluation criteria was changed.

Savings to USD 32.2M is the price difference between initial price of Alcatel of USD 89.7 & final awarded prices of USD 57.5 cannot be accepted. It is true that, as per the SECT report dated 4.4.2014; it was recommended Alcatel to award the contract on the basis of fulfilling the expected coverage to the value of USD 89.7Mn whereas it was not submitted to STB. The same SECT had submitted the above report.

As per the response, it is stated that 30% of the scope given to Alcatel at the reduced price due to the new evaluation criteria, which is a misleading facts because, since Huawei had turned down the contract award of 30% of scope and consequently Alcatel was awarded at the same price awarded to Huawei.

Although, sponsor had made several comments that the approval of TSC & STB was obtained to change the evaluation criteria, so far no any approval was submitted for our review. In terms of TOR of TSC, technical clarifications referred from Board of Directors are to be performed.

The response given as to the introduced evaluation formula from which 35% out of total 40% is assigned for bid value leads to become zero marks for the highest bidder is totally incorrect due to the fact that it is violated the fundamentals of guidelines since it was directly expected to remove Alcatel from evaluation process.

Therefore, the explanation given by SECT cannot be accepted.

#### **(b) Incorporation of subsequent Prices of ZTE (Audit Finding no 4)**

As per the response of SCET, according to the meeting held on 13.6.2014 the price clarification was called from two vendors (a) previously non-captured items & (b) Upgrading the existing EPS, HSS etc.



This violates the tender procedure & procurement guideline. Under the circumstance, the laid down procedure is clearly stated in procurement guideline.

Further, SECT had stated that 4 round of negotiations up to 30.4.2014 were carried out with the qualified vendors as to the certain clarifications on capacities and non-captured activities needed from the vendors thereby a questions is arisen as to why ZTE had failed to include the prices of non-captured items with the price bids submitted on 30.4.2014.

**As per the tender document clause no 2.2.2 it is stated that any missing components found in the evaluation as a fulfillment of based solution will be considered as Free of Charge (FOC) to SLT in order to make evaluation fair to others. Copy is attached in Annexure no 5.**

Therefore, under the above circumstance, it appears that the above responses of SCET are erroneously fabricated to mislead the audit query thereby this can be treated as a fundamental violation of laid down tender procedure. Hence, the explanation given by SCET cannot be accepted.

**(c) Absence of price quotations of vendors for adjusted BOQ (Audit Finding no 5)**

As per the response, it is stated that Chairman/SCET had instructed to the procurement division to send a mail to all three bidders on 29.4.2015 whereas as per the SECT report, the decision was taken to reduce the number of eNodeB as per the guideline & the approval granted by TSC on 29.8.2014 which is nearly 4 months later than the above date thereby the responses given by SECT are baseless and not acceptable.

The audit query was as to their failure to call for fresh price quotations from all three bidders at the above date 29.8.2014 but not the date on (29.4.2014) which they have instructed to procurement division to send mail to the suppliers.

**(d) Price Calculation for Final BOQ (Audit Finding no 6)**

SCET has accepted that the price calculation for the three bidders were carried out equal complexity & detailed.

SCET & sponsor further accepted that they are collectively conversant & aware of the basis of the above calculations.

One of the classic examples for erroneous price calculations performed by SECT as to the price discount offered by Huawei is stated below.

Description	Y1	Y2	Y3
Discount offered by Huawei as per price bids	24.30	25.83	25.83
Discount calculated by SECT	25.83	25.83	24.30

Under the above circumstance, the responses given by SCET cannot be accepted.



## Conclusions

- (a) During the course of reviewing & analyzing the responses given by SECT, it revealed that their explanations are not complied with the laid down tender procedure & the guideline defined by the management. In this context, SCET has violated the fundamentals and the practices that are to be adopted in the process of commercial evaluation.
- (b) The procurement guidelines & the procedures have been defined by the management in order to maintain the visibility & integrity whereas those fundamentals have been intentionally violated by SCET in terms of above (a) & (b).
- (c) The SCET has misled the STB and the Board of Directors by providing misleading facts with a view to make undue influence to the ear-marked vendors eliminating the suppliers who represent a substantial market share in LTE network in the global market & technical viable vendors and despite the fact that the suppliers proposals with optimum solutions were neglected by subsequent manipulations.
- (d) Due to the fact that the subsequent prices submitted by M/s ZTE after cutoff date of 30.4.2014 was considered by SCET for final commercial evaluation, SLT has incurred a loss of USD 7.67Mn
- (e) As per the above price calculation of M/s Huawei under 6 (b) above, it appeared that the price was escalated by USD 5.94Mn which was due to fabricated the prices of user license thereby the 30% of scope was calculated based on the said fabricated price.
- (f) In terms of above (d) & (e) it appeared that the total loss incurred to SLT is USD 13.61Mn.
- (g) Under the above circumstance, the savings of USD 32.2Mn during the implementation of the project which is due to effort of project sponsor is null & void.

## Recommendations

Considering the above facts & audit findings it is recommended,

- (a) To submit the above facts & audit findings to the Audit Committee for their review & comments thereon.
- (b) To appoint an independent consultant for further review of the said facts & audit findings for its confirmation.
- (c) In the case if the audit findings are proved by the consultant, it is recommended to implement the followings actions.
  - 1. To remove from the position of project sponsor (Mr. M.B. Herath) & Project Manager (Mr. L.C.A. Sirimanne) forthwith due to the fact that further decision making as to the LTE project implementation under the supervision of the said officers are not advisable.
  - 2. To take stern disciplinary actions against the all members of SCET and against the project sponsor forthwith.
  - 3. To lodge the case in CID for further investigations.

4. Under the above circumstance, it revealed that substantial discrepancies & major deviations have been taken place during the course of SECT evaluation thereby it is advisable to consider to withhold the operations of the existing contracts agreements signed with the vendors under the provisions of contract agreement clause no 27 until a proper study & review is carried out as to the process of awarding the contract. Pl. refer annexure No 4.