



OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/DOMINICAN REPUBLIC'S RURAL ECONOMIC DIVERSIFICATION PROJECT

AUDIT REPORT NO. 1-517-10-005-P
MARCH 16, 2010

SAN SALVADOR, EL SALVADOR



Office of Inspector General

March 16, 2010

MEMORANDUM

TO: USAID/Dominican Republic Mission Director, Richard Goughnour

FROM: Acting Regional Inspector General/San Salvador, Ismail Kenessy /s/

SUBJECT: Audit of USAID/Dominican Republic Rural Economic Diversification Project (Audit Report No. 1-517-10-005-P)

This memorandum transmits our final report on the subject audit. We have carefully considered your comments on the draft report in finalizing the audit report and have included your response in appendix II of the report.

The report contains four recommendations intended to improve effectiveness and implementation of USAID/Dominican Republic's Rural Economic Diversification Project. Management decisions have been reached for Recommendation Nos. 1 and 2. M/CFO/APC will record final action on these recommendations when planned actions have been completed.

Management decision on Recommendation Nos. 3 and 4 can be reached once USAID/Dominican Republic develops, in conjunction with the lender and implementing partner, a system to review proposed guaranteed loans to ensure that the loans support cluster development and long-term capital investments. Please advise my office within 30 days of any further actions planned or taken to reach management decisions on these recommendations.

I want to express my appreciation for the cooperation and courtesy extended to my staff during the audit.

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SUMMARY OF RESULTS

The Central American-Dominican Republic-United States Free Trade Agreement (CAFTA-DR) first entered into force between the United States and the Dominican Republic on March 1, 2007. This agreement offers Dominican farmers both opportunities for exports and challenges from imports, as countries participating in this free trade agreement are to eliminate tariffs. To support the Dominican Republic's transition to more open agricultural markets, on February 1, 2008, USAID/Dominican Republic (USAID/DR) signed an \$11.7 million, 3-year contract with Abt Associates to implement the USAID Rural Economic Diversification (USAID/RED) project. The contract also provides for two option years for an additional estimated cost of \$7.5 million. The main goal of the project is to help create and strengthen viable, sustainable agricultural clusters (groups of agricultural producers, processors, buyers, and suppliers who work in close geographic proximity to one another). As of October 30, 2009, the mission had obligated \$7.9 million and had expended \$5.76 million under this contract (page 3).

The audit concluded that the USAID/RED project is providing considerable assistance to the Dominican Republic's agricultural sector. However, the project has achieved only limited progress toward its main goal: the development of sustainable agricultural clusters. According to the contact, the clusters were to focus on nontraditional agricultural products. To improve the likelihood of project success, USAID/DR needs to (1) refocus project funds and resources toward achieving the main goal of creating and strengthening viable economic clusters, (2) develop more effective performance measures, and (3) refine and expand the credit program to better support program goals (page 5).

As of November 2009, the USAID/RED project has identified only 9 out of the 15 anticipated clusters that were to achieve 30 percent increases in annual sales. Furthermore, the project has no effective method to evaluate the progress or success of various groups, such as increased sales and profits, and no specific plans to address the sustainability of individual clusters. For example, while the contractor reports that all of the agricultural clusters and productive groups it has assisted are "successful," the contractor has no criteria for defining or evaluating success. Moreover, specific progress toward the 30 percent increased sales goal has not been tracked or submitted, and the contractor has not developed plans to evaluate the sustainability of individual clusters (page 5).

The audit further identified that the USAID/RED project provides extensive assistance to areas unrelated to clusters or agricultural diversification. For example, of the \$2 million in grants approved by the project, only 10 percent of the grant program funds were devoted to the 9 value chain clusters, with the remaining 90 percent devoted to producers outside of the clusters as of September 30, 2009. These outside producers focused on nontraditional agricultural products (page 6).

Furthermore, the project's efforts to improve access to credit are not fully supporting the program goals. More than half of the loaned value has supported traditional protected crops like rice; this support works against the program's diversification goals as it offsets the loans provided to growers of diversified products. Also, while the credit program was targeted for infrastructure improvements, most loans have been for terms of 12 or fewer

months and therefore have been used to finance short-term operational needs. Producers indicated that short term loans would not allow them to invest in infrastructure to improve production, quality, and profitability (page 6).

The report contains the following four recommendations to address these project areas:

- develop a plan to appropriately focus contractor efforts and resources on the original goal of cluster development (page 9).
- prepare and approve new performance indicators that are more likely to determine the progress achieved by specific clusters assisted by the project and the sustainability of the clusters (page 9).
- develop, in conjunction with its implementing partner and the Development Credit Authority lender, a system to allow the mission to review proposed guaranteed loans to ensure that these loans are limited to diversified products supported by the project (page 10).
- develop, in conjunction with its implementing partner and the Development Credit Authority lender, a system to allow the mission to review proposed guaranteed loans to ensure that these loans have longer maturities and primarily support capital investment (page 11).

USAID/Dominican Republic agreed to implement and has developed specific plans to address the first two recommendations. The audit team determined that management decisions have been reached on these two recommendations. Management decisions can be reached on the remaining two recommendations when the mission develops a review system to determine if loans are targeted for the diversified products supported by the USAID/RED project, and if they are focusing on longer term capital investments. An evaluation of management comments is provided in the Evaluation of Management Comments section of this report (page 12), and USAID/Dominican Republic's comments in their entirety are included in appendix II.

BACKGROUND

The Central American-Dominican Republic-United States Free Trade Agreement (CAFTA-DR)¹ first entered into force between the United States and the Dominican Republic on March 1, 2007. It offers Dominican farmers the opportunity to sell their commodities free of import tariffs in the United States and in Central American countries participating in this free trade agreement, provided that they maintain competitive prices and comply with the importing country's food safety and certain sanitary requirements. However, the agreement will also entail challenges to farmers of protected crops, which will eventually have to compete freely with producers from the United States and Central American countries. Protectionist practices in the Dominican Republic have caused strong economic distortions leading to inefficiencies in agricultural production. Protection and subsidies have made rice, beans, onions, and dairy the most vulnerable and least competitive products.

To support the Dominican Republic's involvement in CAFTA-DR, on February 1, 2008, USAID/Dominican Republic (USAID/DR) signed an \$11.7 million, 3-year contract with Abt Associates to implement the USAID Rural Economic Diversification (USAID/RED) project. The contract also provides for two option years for an additional estimated cost of \$7.5 million. The project is designed to help the Dominican Republic take advantage of the new export opportunities provided by the elimination of tariffs.

The main goal of the project is to help create and strengthen viable, sustainable agricultural clusters. According to the contract, clusters are groups of agricultural producers, processors, buyers, and suppliers who work in close geographic proximity to one another—along with local/community leadership—to promote the production and marketing of a specific product while using environmentally sound practices. According to the contract with Abt Associates, specific goals of the 3-year project include:

- strengthening at least 15 nontraditional export commodity chains into viable agro-industries linked to markets, while the average value of related product sales should increase by 30 percent annually;
- reaching agreements with two financial institutions to develop financial products for competitive agricultural clusters, leading to at least 500 beneficiaries being provided credit for cluster-related activities;
- exceeding a 5,000-hectare target of new areas under improved natural resources management for agricultural and wood sustainable products;
- leveraging at least \$5 million of non-USG resources (alliance with the private sector) to further the objectives in support of contract results; and

¹ CAFTA-DR includes seven signatories: the United States, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua. The U.S. Congress approved the CAFTA-DR in July 2005 and the President signed the implementation legislation on August 2, 2005. The United States has implemented CAFTA-DR on a rolling basis as countries make sufficient progress to complete their commitments under the agreement. The agreement is now fully in force with all seven signatories.

- disbursing \$1 million per year for grants that will support all the project's technical tasks.

As of October 30, 2009, the mission had obligated \$7.9 million and had expended \$5.76 million under this contract.

AUDIT OBJECTIVE

As part of the fiscal year 2010 audit plan, the Regional Inspector General/San Salvador audited USAID/Dominican Republic's Rural Economic Diversification Project to answer the following question:

- Is USAID/Dominican Republic's Rural Economic Diversification Project achieving its main goals?

The audit's scope and methodology are described in appendix I.

AUDIT FINDINGS

Is USAID/Dominican Republic's Rural Economic Diversification project achieving its main goals?

While the USAID/Dominican Republic's Rural Economic Diversification (USAID/RED) project is providing considerable assistance to the Dominican Republic's agricultural sector, the project has achieved only limited progress toward its main goal: the development of sustainable economic clusters made up of competitive and profitable producers, processors, buyers, and suppliers of nontraditional agricultural products.

The USAID/RED project is providing substantial assistance to clusters, producer groups, and other parts of the agriculture sector. This assistance includes increased access to credit, the establishment of a private sector alliance, the strengthening of nontraditional export clusters, and the provision of financial support through grants. Specific accomplishments of the program include:

- The USAID/RED project has identified and begun strengthening nine clusters that fit the contractual definition of nontraditional export commodity chains that the USAID/RED project hopes to strengthen into viable agro-industries linked to markets. Targeted clusters focus on such products as mangos, bananas, pineapples, and yucca/cassava.
- USAID/RED has successfully obtained an agreement from a domestic financial institution operating under a Development Credit Authority (DCA) guarantee to provide credit to agricultural producers. This institution has issued 1,623 loans in the amount of \$4.5 million as of September 30, 2009.
- USAID/RED has leveraged about \$2.8 million of local resources to further the objectives of the contract. This sum includes contributions from grantees. In addition to this, a public private partnership agreement has been signed with a private U.S. food distributor that will provide about \$53,000 of non-USG resources, with two more agreements in negotiations.
- About \$2 million in grants have been disbursed to support the project's technical tasks. For example, grant money helped a group of coffee producers purchase new equipment that helped them improve their coffee production and in turn the quality of the coffee. This led to the producers finding buyers in Japan to purchase their improved coffee. In another case, a group of yucca growers was able to purchase a pump that improved the group's irrigation system.

However, despite the achievement made by the project and assistance provided thus far, there is limited evidence that the project will meet many of the specific goals stated in the contract. Specific concerns include the following:

- As of November 2009, the USAID/RED project has identified only 9 of the proposed 15 economic clusters. These identified groups vary significantly in their level of development, and it is not clear which clusters are becoming more viable and

sustainable. The USAID/RED project has no effective method to evaluate the progress or success of various groups, such as increased sales and profits, and no specific plans to address the sustainability of individual clusters.

- While the USAID/RED contract anticipated the development of 50 higher value products and services to support economic diversification, the contractor has identified only 4 such products so far.
- While the contract anticipated that all 15 clusters would have members with product certifications (such as *certified organic*) to enhance marketability, as of September 30, 2009, members of only 2 clusters had received such certifications
- While the contract anticipated that 50 documented agreements will be in place between producers and large agricultural firms (including exporters and foreign importers) for business-to-business services, only 4 such agreements have so far been reported.
- Although the contract's grant program was expected to support all of the project's technical tasks, as of November 2009, the nine identified clusters had received little of the project's grant money. As of September 30, 2009, about 90 percent of the grant money had been distributed to agricultural producers outside the clusters.
- Progress toward natural resource management targets could not be confirmed. While project indicator data indicates that hectares under improved natural resources management reached 213 percent of the fiscal year (FY) 2009 target, the contractor was unable to provide verifiable data to confirm this result.
- The improved access to credit is not fully supporting the program goals. More than half of the loaned value has supported traditional protected crops such as rice. This trend works against the program's diversification goals as it offsets the loans provided to growers of diversified products.
- Given that the improved access to credit is linked to the overall development of clusters, most loans should be for capital investments that can impact production or profitability. Loans of this nature require a longer period of maturity. However, most loans have been given to finance short-term operational needs and have been for 12 or fewer months. Producers interviewed indicated that short term loans would not allow them to improve production, quality, or profitability.

To increase the likelihood of project success, USAID/Dominican Republic (USAID/DR) needs to take the following steps: (1) refocus project funds and resources toward achieving the main goal of creating and strengthening viable economic clusters, (2) develop more effective performance measures, and (3) refine and expand the credit program to better support program goals. Specific audit findings and recommendations are stated below.

USAID/Dominican Republic Should Increase the Focus on Value Chain Cluster Development

Summary. According to the USAID/RED contract, the project's main goal is to help create and strengthen at least 15 nontraditional export commodity chains that can become viable agro-industries. Automated Directives System (ADS) 203.3.4 states that performance indicators are used to observe progress and measure actual results against expected results. While the project is providing significant support to the agricultural sector, there is limited evidence of significant progress toward the project's overall objectives. For the nine clusters identified so far, USAID/DR has not tracked progress or developed plans to ensure sustainability. Furthermore, significant resources are expended on groups outside the clusters and for agricultural groups unrelated to the diversification goals. This situation occurred because USAID/DR did not closely track contractor compliance with contract provisions and did not ensure that indicators were developed in accordance with ADS requirements. Without improved focus and reporting, there is increased risk that the program's main goals will not be achieved.

According to the USAID/RED contract, an important expected result is that at least 15 nontraditional export commodity chains are strengthened into viable agro-industries linked to markets, with the average value of product sales increasing by 30 percent annually. In addition, the contract states that the project's main goal is to help create and strengthen clusters made up of competitive, profitable, commercially oriented agribusiness value chains. Automated Directive System (ADS) 203.3.4 indicates that performance indicators are used to observe progress and to measure actual results compared with expected results. To be effective, indicators should allow missions to systematically monitor the achievements of program operations; collect and analyze performance information to track progress toward planned results; use performance information and evaluations to influence decision-making and resource allocation; and communicate results achieved.

While the USAID/RED project is providing significant support to various clusters, producer groups, and other agricultural sector entities, there is limited evidence of significant progress toward the project's overall objectives. As of November 1, 2009, the project has identified nine clusters that meet the contractual definition of nontraditional export commodity chains, and the contractor is working with these groups to develop into viable agro-industries linked to markets. However, evidence of specific progress towards the development of profitable and sustainable clusters is lacking because of the following conditions:

USAID/DR has not received relevant and reliable data regarding the progress of clusters - Effective performance indicators allow missions to systematically monitor the achievements of program operations; collect and analyze performance information to track progress toward planned results; use performance information and evaluations to influence decision-making and resource allocation; and communicate results achieved. However, the indicators developed by the contractor do not always clearly reflect the progress of each value chain cluster to allow the assessment of progress made towards the main goal of the project. Specifically:

- While the contractor maintains a performance indicator and reports on the “number of successful agricultural clusters or productive groups in operation”, the contractor has no criteria for defining or evaluating the success of individual clusters or groups. As of September 30, 2009, all groups receiving assistance were reported as successful, although USAID and contractor officials agreed this did not mean all had achieved the intended goal of becoming a cluster made up of a competitive, profitable, commercially oriented agribusiness value chain. Specific progress toward the 30 percent increased sales goal has also not been tracked or submitted as of yet, as it is not a specific indicator being tracked.
- Some performance indicators include targets and results aggregated from all groups aided by the project (value chain clusters, productive groups, and other producers), making it difficult to track progress toward the project objective of 15 functioning clusters. For example, the performance indicator for quality certifications counts individual farmers who were certified, and shows that the project achieved 270 percent of its target. However, the contract states that members from all 15 clusters would receive certifications; so far, members from only 2 of 15 planned clusters (13 percent) have received certifications.
- There are no indicators showing progress toward sustainability, such as increased cluster membership, participation rates, increased income or profit among growers, the ability to finance or support group operations that could help one to determine the progress of clusters assisted to date.
- The contractor was unable to fully document reported progress in the environmental area. While the project indicator data show that hectares under improved natural resources management reached 213 percent of the FY 2009 target, the audit team was unable to verify this result from the data available by the contractor.

The contractor has not developed plans for cluster sustainability - While the sustainability of the value chain clusters is identified as a key implementation element, the contractor has taken few clear steps to identify needed work. In the contractor’s work plan for FY 2009, the only identified work relates to monthly meetings to discuss sustainability. While the contractor is responsible for developing a Sustainability Report focused primarily on mechanisms for transitioning assistance efforts from USAID/RED to a local institution; it does not address the specific status or needs of the existing clusters, or the work needed to ensure group sustainability.

The USAID/RED project provides extensive assistance to areas unrelated to clusters or diversification - In addition to the 9 clusters that can develop into the intended value chain clusters, the project has expanded its efforts to include support for 9 producer groups, and 22 other recipients receiving grants. According to project officials, the 9 producer groups are not likely to develop into value chain clusters, while the 22 smaller groups receiving only grants are even less likely to do so. Thus, many resources are devoted to these groups, and while this assistance is worthwhile in general, it is not contributing to the original main goal of developing value chain clusters. For example, only 10 percent of the grant program funds were devoted to the value chain clusters, 9 percent to the producer groups, with the smaller producers receiving 81 percent of the grants as of September 30, 2009. In some instances project resources

are being applied to producer groups of traditional products such as pork and dairy; support for these sectors is unrelated to the goals of diversification and cluster development.

These problems occurred because USAID/DR failed to develop appropriate performance indicators in accordance with ADS requirements. Furthermore, the mission did not provide sufficient technical guidance and direction to ensure that the contractor retained its primary focus on diversification, cluster development, and the sustainability of individual clusters.

Unless the USAID/RED project focuses sufficient resources on the contract's main goal of strengthening diversification through cluster development as originally envisioned by the contract, there is an increased risk that the overall goals of the project will not be achieved. Without appropriate performance indicators directly tracking the progress towards the main goal of the project, USAID/DR management cannot use performance information and evaluations to influence decision-making and effectively communicate results achieved. To ensure that the mission provides appropriate attention to the identified problems, we are making the following recommendations:

Recommendation 1. *We recommend that USAID/Dominican Republic, in conjunction with the Rural Economic Diversification project contractor, develop a written implementation plan to appropriately focus contractor efforts and resources on the original goal of cluster development.*

Recommendation 2. *We recommend that USAID/Dominican Republic prepare and approve new written performance indicators that are more likely to determine the progress achieved by specific clusters assisted by the project and the sustainability of the clusters.*

USAID/RED's Loan Program Should More Effectively Support Project Objectives

Summary. According to the USAID/RED contract, the project should support agricultural diversification by improving access to credit by members of the various supported agricultural clusters. However, according to documents from the financial institution providing loans, more than half of the loans were received by producers of traditional protected crops such as beans and rice. Furthermore, because of the short duration of the loans offered, most of the loans have financed short term operational needs instead of long-term investments in needed infrastructure and facilities. This occurred because the agreement between USAID/DR and the lending institution did not contain specific language limiting the type and duration of loans in a way that would best support the project's objectives. As a result, the credit program does not fully support, and may in some cases actually work against, the investment and diversification goals of the USAID/RED project.

According to the USAID/RED contract, the project would support agricultural diversification by improving access to credit by members of the various supported agricultural clusters.

Specifically, the project would identify lenders to implement a Development Credit Authority (DCA) guarantee program to finance the infrastructure and facilities required to improve cluster competitiveness and expand cluster output. Under this program, USAID's DCA program provides partial loan guarantees to financial institutions to encourage loans to small farmers and other entrepreneurs, loans that have traditionally carried higher risks. According to the contract, improved access to credit is to be achieved by assisting at least two financial institutions to develop financial products aimed at competitive agricultural clusters by the end of the 3-year project.

In September 2008, the project entered into an agreement with one financial institution operating with a DCA guarantee program to provide loans to agriculture producers. As of September 2009, the lender had completed about \$4.5 million in loans. However, according to documents obtained from the primary lender, and from discussions with the contractor and USAID officials, more than 50 percent of the loans given under the DCA guarantee have not gone to diversified agriculture producers. They have instead gone to producers of traditional, protected crops such as rice, beans, and onions—crops that currently benefit from government subsidies and tariffs. In addition, most loans issued have been to finance short term operational needs and have been made for terms of 12 or fewer months. According to beneficiaries and officials from USAID/DR, the contractor, and the Government of Dominican Republic, financial products of 3 to 5 years for capital investments are needed to achieve impact.

The lender is making these types of loans because, under the current financing agreement with USAID, they can make short-term loans with a 12-month minimum duration. The lender prefers to make short-term loans to producers of traditional crops because such loans traditionally have been seen as less risky. However, the purpose of the loan program is to reduce the risk of lending to producers of non-traditional crops, and to support long-term investment in infrastructure to support diversification.

The credit program does not fully support these goals at this time. Unless the lending policies are changed, the loans provided to traditional producers may further entrench these traditional crops and make it harder to diversify agriculture producers in the country as a whole. If a new agreement with the lender limits loans to only those farmers committed to diversification and only for capital investments, the amount and number of loans may lessen, but all of the loans will then go towards achieving the goal of diversification and cluster development of the project.

According to USAID/DR, the current credit program agreement requires the lender to use at least half of its DCA-covered loans to underwrite the diversified products supported by the USAID/RED Project. Furthermore, USAID/DR stated that it would insist that the lender focus in the future on the longer-term capital investment needs of cluster participants. However, because the lending program has so far failed to achieve these goals, the mission should develop a more active system for monitoring of lending activity. To ensure that a monitoring mechanism is in place to facilitate the project goals, we are making the following recommendations:

Recommendation 3. *We recommend that USAID/Dominican Republic develop, in conjunction with its implementing partner and the Development Credit Authority lender, a system to allow the mission to review proposed guaranteed loans to ensure that these loans are limited to diversified products supported by the project.*

Recommendation 4. *We recommend that USAID/Dominican Republic develop, in conjunction with its implementing partner and the Development Credit Authority lender, a system to allow the mission to review proposed guaranteed loans to ensure that these loans have longer maturities and primarily support capital investment.*

EVALUATION OF MANAGEMENT COMMENTS

In response to our draft report, USAID/Dominican Republic agreed to implement and has developed specific plans to address Recommendations 1 and 2. With regard to Recommendation 1, the mission stated that they expect to have a plan to focus contractor efforts and resources on cluster development in place by the end of March 2010. As to Recommendation No. 2, the mission indicated by April 20, 2010, they would put in place a revised set of project performance indicators, including indicators specifically related to cluster group success. Based on the mission's actions taken, a management decision has been reached on Recommendations 1 and 2.

In response to Recommendations 3 and 4, the mission stated that amending the Development Credit Authority (DCA) program is not advisable. The mission further explained that the current DCA contract allows for USAID/Dominican Republic to insist that the remaining loans be targeted towards diversified products supported by the USAID/RED project. The contract also allows for the remaining loans to be focused on longer-term capital investments needs. In response to these comments, the report recommendations have been adjusted. Rather than proposing a contract amendment, the recommendations now require the mission work with the lender and implementing partner to develop a review system of proposed guaranteed loans. The review system will allow the mission to determine if loans are indeed going to diversified products supported by the USAID/RED project, and if the loans focus on longer-term capital investments needs. The audit team requested that the mission provide within 30 days information regarding actions planned or taken to reach management decisions on these revised recommendations

Mission comments in their entirety are presented in appendix II.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/San Salvador conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The purpose of the audit was to determine if USAID/Dominican Republic's Rural Economic Diversification (USAID/RED) project is achieving its main goals. Audit fieldwork was conducted at USAID/Dominican Republic (USAID/DR) and contractor's offices in Santo Domingo from November 2 to 20, 2009 and included site visits to beneficiaries in Bani, Santiago, Dajabon, and Moncion. The audit covered the period from February 1, 2008, through November 20, 2009.

In planning and performing this audit, we assessed the mission's controls related to its USAID/RED activities. The management controls identified included the mission performance management plan, program progress reports, USAID/DR's strategy documents, and the mission's fiscal years (FY) 2008 and 2009 self-assessment of management controls as required by the Federal Managers' Financial Integrity Act of 1982.²

The audit was conducted at USAID/DR and contractor's offices in Santo Domingo. Our audit primarily focused on the achievement of main goals under the USAID/RED project and the associated indicators for FY 2009. We reviewed the eight tasks under the contract as well as the grant portion. We judgmentally selected five producer groups and one local partner, and reviewed associated indicators under each task from the monitoring and evaluation plan to determine the results achieved. Our analysis and conclusions are restricted to the controls in place at locations visited during the audit.

Methodology

To determine whether the USAID/RED project is achieving its main goals, the audit team first met with and interviewed USAID/DR staff in the mission's Office of Economic Growth to gain an understanding of the program history and status. The audit team reviewed relevant documentation such as the contract, contract amendments, semiannual progress reports, field trip reports, and mission operating plans. The audit reviewed the work accomplished as reported in the contractors' reports and compared actual accomplishments to the specific outputs as defined in the contract and approved work plans. This comparison entailed examining supporting records, including documented deliverables and the contractor's progress reports, for evidence that the project had achieved its intended results.

To assess the mission's compliance with requirements to document program performance, we tested a judgmental sample of outputs based on program maturity, accessibility, and total dollars committed in grants, under each major task and verified

² Public Law 97-255, as codified in 31 U.S.C. 1105, 1113, and 3512.

reported progress related to these outputs during site visits and interviews with the contractor staff, local officials, and beneficiaries. Based on the collective results, we determined the progress of each major task toward the achievement of the main goals stated in the contract documents.

In addition, we reviewed applicable policies, procedures and management controls related to the management for results, including Automated Directives System chapters 202 and 203. We evaluated the mission's compliance with relevant program management controls and policies.

In assessing the accuracy of reported results, we established a materiality threshold of 95 percent. If the reported results could be verified and if the difference between reported and documented results was less than 5 percent, the reported results were judged to be accurate.

MANAGEMENT COMMENTS

MEMORANDUM

To: Jon Chasson, RIG/San Salvador
 From: Richard Goughnour, Mission Director, USAID/Dominican Republic
 Date: February 26, 2009
 Subject: Management Decisions for Recommendations Contained in Report No. 1-517- 10-00X-P: Audit of USAID/Dominican Republic's Rural Economic Diversification Project

On January 25, 2010, RIG/San Salvador issued its draft report on its audit of USAID/Dominican Republic's Rural Economic Diversification (RED) Project and asked the Mission's for its review and comments on it. The draft audit report contains four recommendations, listed below, which the Mission wishes to respond to in the following manner:

Recommendation 1: *"We recommend that USAID/Dominican Republic develop a written plan to appropriately focus contractor efforts and resources on the original goal of cluster development."*

We fully agree with this recommendation that the Mission, together with the USAID/RED Contractor, develop a written plan to focus appropriately contractor efforts and resources on the original goal of cluster development. Using the definition of rural economic product clusters as defined below in the Dominican Republic, the Mission expects to have an appropriate plan written and agreed upon by both parties by the end of March 2010.

A rural economic product "cluster" is "...a critical mass of agricultural or wood producers, processors, buyers, and public and private input suppliers and service providers [i.e., the value chain for a particular product or group of similar products] with the following characteristics:

1. Local/community leadership involvement to promote the production and marketing of a specific agricultural or wood commodity or group of similar commodities (e.g., oriental vegetables) with high growth potential based on high quality products and competitive market prices;
2. Producers, processors, buyers and input suppliers who work in close geographical proximity to one another; and
3. Use environmentally sound production and processing practices."

Recommendation 2: *"We recommend that USAID/Dominican Republic prepare and approve new written performance indicators that are more likely to determine the progress achieved by specific clusters assisted by the project and the sustainability of the clusters."*

USAID/DR agrees with and welcomes this recommendation. We will put in place by April 30, 2010 a revised set of project performance indicators that will include indicators related to cluster group success, including increased sales and sustainability. Along with other appropriate indicators, we will develop assessment instruments and a methodology to

improve the collection and processing of the data needed to assess cluster sustainability.

Recommendation 3: *“We recommend that USAID/Dominican Republic amend the Development Credit Authority [DCA] guarantee program with its current and future collaborating financial institutions to limit the use of the guarantee for only diversified products.”*

USAID/DR believes that this recommendation is not advisable at this time because we think that the current DCA contract with ADEMI Bank is acceptable, but to date has not been implemented by ADEMI Bank as agreed upon. The carefully negotiated contract between USAID/DR and ADEMI Bank, which was approved by the USAID/DCA Office, actually requires the bank to have at least 50% of its DCA-covered loans to go to those diversified products supported by the USAID/RED Project. Moreover, we wish to point out that one of the primary goals of this DCA loan guarantee program, in addition to persuade ADEMI Bank to lend to small firms in the rural sector in general, is to have a demonstration effect for other private Dominican banks to see that lending to these small rural businesses can be profitable. The fact that several other banks have now approached the Mission and the USAID/RED Project expressing an interest in the DCA loan guarantee program for lending to small rural businesses indicates that the demonstration effect is working.

Therefore, we consider that there is no need for a contract modification at this time; however, there is the need to enforce the current one. The Mission will continue to insist that ADEMI Bank has to comply with its current contractual obligations, which implies that the remaining loans covered by the DCA loan guarantee have to go to the diversified products supported by the USAID/RED Project. If the Mission sees by April 30, 2010 that ADEMI Bank is not able to comply with its contractual obligations, the Mission will terminate the USAID/DCA contract with ADEMI Bank and any future lending by ADEMI Bank will not be covered by the USAID/RED Project's DCA loan guarantee program.

All additional collaborating financial institutions receiving a USAID/DCA loan guarantee program in the future will be required to use their USAID/DCA-loan guarantees for only those diversified agricultural or wood products supported by the USAID/RED Project. In this sense, the USAID/RED Project defines product diversification to include both horizontal diversification, which is the change in crop production from a traditional Dominican politically sensitive commodity (e.g., rice, beans, onions, garlic) to another that is primarily a non-traditional Dominican export commodity (e.g., fruits and vegetables), and vertical diversification, which is the improvement in quality or value-added to a specific Dominican agricultural or wood product.

Recommendation 4: *“We recommend that USAID/Dominican Republic amend the agreement with the current and future financial institutions to limit the use of the Development Credit Authority guarantee for only capital investment uses and longer maturity products.”*

Please see our response to Recommendation 3 above which also covers our response to Recommendation 4. That is, we think that a contract modification to the USAID/DCA contract with ADEMI Bank (the only financial institution that currently has a DCA loan guarantee program under the USAID/RED project) is not necessary at this

time because we are insisting that ADEMI Bank complies with its present contract to use the remaining DCA-covered loans to finance the USAID/RED Project-supported cluster activities, especially their longer-term capital investment needs. In addition, all additional financial institutions agreeing to the USAID/RED Project's DCA loan guarantee program in the future will be required to lend only to clusters supported by the USAID/RED Project, and those loans should be used primarily for capital investment loans for more than a year that promote cluster development and rural economic diversification.

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave., NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig