



OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/ECUADOR'S SUSTAINABLE FORESTS AND COASTS PROGRAM

AUDIT REPORT NO. 1-518-14-012-P
JULY 31, 2014

SAN SALVADOR, EL SALVADOR



Office of Inspector General

July 31, 2014

MEMORANDUM

TO: USAID/Ecuador Mission Director, Christopher Cushing
USAID/M/OAA/P Division Chief, Marcelle Wijesinghe

FROM: Acting Regional Inspector General/San Salvador, David Clark /s/

SUBJECT: Audit of USAID/Ecuador's Sustainable Forests and Coasts Program
(Report No. 1-518-14-012-P)

This memorandum transmits our final report on the subject audit. We considered your comments on the draft report and included them in their entirety in Appendix II of this report.

This report contains three recommendations to help improve USAID's reporting regarding challenges encountered and resources leveraged. Your written comments in response to the draft report indicate that you made management decisions on all three. Please provide the Audit Performance and Compliance Division in the USAID Office of the Chief Financial Officer with the necessary documentation to achieve final action.

Thank you and your staff for the cooperation and assistance extended to us during this audit.

CONTENTS

- Summary of Results** 1
- Audit Findings**..... 3
 - Program Did Not Deliver the Economic Benefits Anticipated..... 3
 - Implementer Overstated Leverage by 63 Percent 5
- Evaluation of Management Comments** 7
- Appendix I—Scope and Methodology** 8
- Appendix II—Management Comments** 10
- Appendix III—Program Areas in Ecuador**..... 13

SUMMARY OF RESULTS

Ecuador is known for both its biological diversity and its dramatic rate of deforestation. The Food and Agriculture Organization of the United Nations ranked Ecuador 14th highest in the world in average annual reduction in forests in 2010. The country's forests, including coastal mangroves that shelter fish and other organisms and reduce erosion caused by tides and storms, are threatened by agricultural expansion, illegal logging, and climate change.¹

Despite having protected areas, Ecuador has not managed them well. To strengthen the Government of Ecuador's efforts in protected areas, on June 15, 2009, USAID/Ecuador awarded Chemonics a 5-year cost-plus-fixed-fee contract for the Sustainable Forests and Coasts Program.² It sought to improve biodiversity conservation in critical habitats while improving local livelihoods in target communities through activities linked to conservation goals. In addition, the program sought to develop conservation partnerships with local organizations. The program's total estimated cost through June 2014 was \$15.8 million. As of December 31, 2013, \$15.0 million had been obligated, and \$13.2 million spent.

The Regional Inspector General/San Salvador conducted this audit to determine whether USAID/Ecuador's Sustainable Forests and Coasts Program was achieving its main goal of conserving biodiversity to benefit residents in coastal Ecuador and adjacent forests by establishing long-term partnerships with local organizations.

The audit verified that the mission was achieving its main goals related to conserving biodiversity and developing partnerships for conservation. Specifically, the audit team noted the following accomplishments:

- The program completed studies that provide data critical to managing the supply of crabs in the Gulf of Guayaquil and developed case studies that can benefit other regions and resources.
- USAID closely collaborated with the Ministry of Environment on many activities, including those to strengthen its strategic planning and oversight, improve management policies, and expand environmental education. The mission has supported the ministry's successful Socio Bosque³ Program by helping rural communities meet requirements for participation. These include obtaining land titles and preparing plans detailing how the communities will use the cash payments they receive.
- The program has strong support at the local, regional, and national levels of Ecuadorian government and has developed excellent relationships with implementing organizations and project beneficiaries. The latter group previously did not feel included in planning community

¹ EcoDecision, "ECUADOR: An overview from the REDD Countries Database," April 2012. REDD stands for Reducing Emissions from Deforestation and Degradation, a collaborative initiative launched by the United Nations.

² Federal Acquisition Regulation 16.306 defines this type of contract and its purpose.

³ USAID/Ecuador's 2013 Performance Plan Report characterizes Socio Bosque as a "cash-for-conservation program." It pays individuals and communities that sign a 20-year agreement with the Ministry of the Environment to conserve forests.

activities. The audit team noted that USAID's partners and beneficiaries appreciated the program's flexibility in responding to the communities' needs. For example, some communities requested equipment to boost production of various goods, and the project promised to deliver it.

- The program built or strengthened several networks and coalitions, which are positioned to continue activities that promote their constituents' interests.

The program was less successful at improving local livelihoods in target communities through activities linked to conservation goals, as noted below.

- The program did not deliver the economic benefits anticipated in the contract (page 3). In many cases, the program did not appreciably increase incomes per person through direct assistance in the five value chains, and it did not establish strong commercial links.
- Chemonics overstated leverage⁴ by 63 percent and misclassified public resources as private resources (page 5). Chemonics was unable to create strong private sector alliances, as envisioned in the contract.

The audit recommends that USAID/Ecuador and USAID's Policy Division of the Office of Acquisition and Assistance take the following steps to improve the effectiveness of the program and mission operations:

1. Document in its final report the challenges that this program faced in improving livelihoods, and upload the evaluation to the Development Experience Clearinghouse (page 5).
2. In conjunction with Chemonics, (1) update the definition of the leverage indicator to include only resources leveraged during the life of the program, (2) classify nonprofits as public institutions and for-profits as private institutions, (3) disaggregate private and public resources leveraged when reporting, and (4) report revised figures in its final report (page 6).
3. Update the Automated Directives System (ADS) Chapters 302 and 303 to include clear definitions and criteria for identifying and classifying leverage under contracts outside of formal Global Development Alliance activities (page 6).

Detailed findings appear in the following section. The scope and methodology are described in Appendix I. Management comments appear in their entirety in Appendix II, and our evaluation of management comments is on page 7.

⁴ Leverage refers to resources that an implementer mobilizes from entities other than the U.S. Government to offset project or program costs.

AUDIT FINDINGS

Program Did Not Deliver the Economic Benefits Anticipated

According to the contract, Chemonics would improve local livelihoods in target communities through activities linked to conservation goals:

- Provide economic benefits to 10,000 individuals by the end of fiscal year 2013, primarily by developing five value chains⁵—agriculture, fisheries, wood products, nontimber forest products, and tourism—that could increase incomes while still protecting national resources.
- Seek opportunities to develop other environmentally friendly value chains.
- Link 20 Ecuadorian enterprises to national, regional, and international markets for sustainably produced goods and services.
- Identify partners—buyers, producers, and banks—to support these efforts.

The program allocated more than \$6 million to improve livelihoods, which represents about 40 percent of the total program expenditures. According to Chemonics, the program surpassed its target for boosting incomes and savings, providing economic benefits to 16,225 individuals.

Despite the positive reporting and the significant investment in environmentally friendly value chains, the program created only limited economic benefits for a substantially smaller number of beneficiaries. Most of the beneficiaries the program reported (13,465, or 83 percent) did not receive economic benefits from direct program activities; rather, they received economic benefits from the Government of Ecuador's Socio Bosque Program. The program spent about \$500,000 to support Socio Bosque activities and by including a large number of Socio Bosque beneficiaries in its reporting, the program is misrepresenting its own role in assisting the groups targeted by the contract.

Direct beneficiaries numbered 2,760. The program spent more than \$5.5 million to raise their incomes by developing value chains, but many people realized only slight improvements. For example, Chemonics reported that the average annual increase in income for participants working in the forestry sector was only \$53 per year. Among farmers, if one increased his income by as little as \$12 per year, the program counted this as an increased benefit for a family of five.

Economic benefits were so small because the program was largely unable to establish profitable, environmentally friendly economic links and value chains. None of the commercial connections involved regional or international markets as expected by the contract, and the 20 links with local markets generated only a small amount of sales.

⁵ A value chain includes all activities required to produce a good or service and deliver it to the final customer. Value chains include activities such as production, marketing, and distribution.

For example, as of September 2013, seven ivory palm⁶ trade arrangements had generated an average of only \$892 in increased sales per enterprise. This small increase was shared by dozens of producer families. By September 2013, nearly half of the economic links established by the program had failed, demonstrating that developing enterprises in the targeted areas was extremely challenging for the program.

USAID/Ecuador and Chemonics officials offered several reasons for the disappointing results:

- The current USAID team managing the program and Chemonics said the scope of work was too ambitious and did not reflect the program's challenges. The program was designed by USAID/Ecuador staff who had higher expectations for economic growth in the targeted areas. For example, the contract suggested including sales increases as an indicator, but these figures were so unimpressive that Chemonics did not formally track or report them. As another example, the program's efforts to assist local businesses with business plans, financing, and facilities development have been minimal. When implementation began, program officials, largely environmentalists, quickly realized that the contract was too optimistic when their rapid assessments showed that targeted communities had very little potential for developing new products and engaged mostly in subsistence farming.
- The Chemonics team was generally made up of highly qualified and experienced environment professionals. However, none had significant experience in business development, as Chemonics and USAID staff were more concerned about the project's focus on conservation.
- The targeted areas, which included remote forests and coastal areas, lack the infrastructure and equipment to expand their business operations and transport goods to market. For example, some communities are accessible only by boat or by lengthy walks. Because conservation is a priority, the program did not include building any infrastructure.
- The targeted beneficiaries generally lacked formal education, business experience, and knowledge of best business practices. Chemonics officials believed that training them to become successful entrepreneurs would require more resources than were available during the program.
- According to Chemonics officials, poor weather adversely affected the production of some items. For example, the 2011 cacao production in Esmeraldas was severely limited because of a drought. In 2013, inadequate rainfall dramatically reduced the harvest of high-quality ivory nut.

As a result, the program has not had the economic impact the contract envisioned. It did not create much economic benefit through direct assistance in the five targeted value chains, and it did not establish strong commercial ties. The results are particularly disappointing given the millions of dollars allocated to these activities.

The weak program results highlight the challenges facing programs that seek to provide economic benefits while encouraging conservation, and may offer lessons for future programs. According to ADS 203.1, USAID missions "must strive to continuously learn and improve their approach in achieving results." Missions must submit evaluation reports to USAID's central

⁶ Ivory palm is a South American tree whose hardened fruit, the ivory nut, is used to make buttons, beads, and figurines.

document repository, the Development Experience Clearinghouse, to promote the sharing of information. To see that lessons learned from this program are shared, we make the following recommendation.

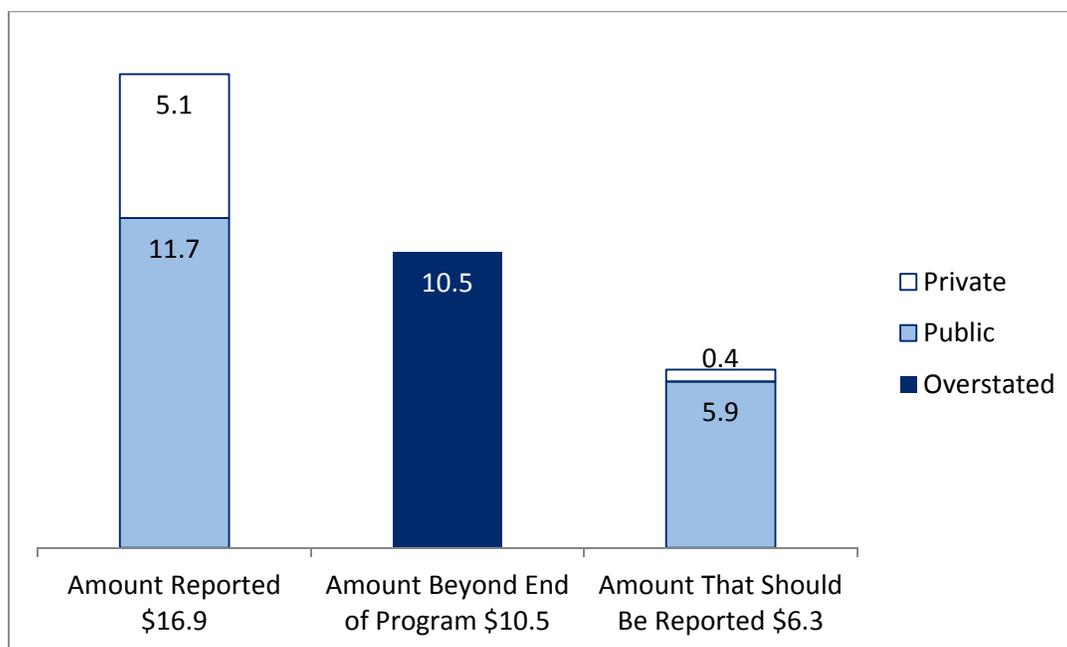
Recommendation 1. We recommend that USAID/Ecuador document the challenges faced in improving livelihoods in its final report and upload the evaluation to the Development Experience Clearinghouse.

Implementer Overstated Leverage by 63 Percent

According to the contract, leveraging private sector resources was an important aspect of the program, and Chemonics was expected to develop strong, Global Development Alliance (GDA)⁷-like alliances with the private sector. The contract committed Chemonics to leverage at least \$4.5 million in public and private funds, and the amount of leveraging achieved was tracked as one of the program’s nine indicators.

As of September 30, 2013, Chemonics reported that it had leveraged \$16.9 million in non-USAID resources for the program, of which \$11.7 million came from the public sector and \$5.1 million from the private sector, as shown below (difference from total due to rounding).

**Amount Leveraged as of September 30, 2013 (Unaudited)
(\$ million)**



However, these amounts significantly overstated the amount of leveraging achieved. Chemonics counted contributions that the Government of Ecuador anticipated making over the

⁷ A Global Development Alliance is a partnership between USAID and the private sector in which the partners work together to develop and implement activities that meet the objectives of both while advancing development.

next 20 years through the Socio Bosque Program, as well as future contributions from the Inter-American Development Bank. According to USAID's Acquisition and Assistance Policy Directive 04-16, "Leveraging refers to that portion of a project or program costs not borne by the Federal Government." Thus, it does not include contributions that presumably will occur after the program ends. Chemonics should have reported only contributions made during the life of the program. Counting future contributions by the partner government assumes continued political support and resources. As a result, Chemonics overstated the amount of actual leverage by 62.6 percent; the amount reported should have been \$6.3 million.

Furthermore, Chemonics made errors when classifying public and private leveraging achieved by the program. Chemonics classified contributions by the Inter-American Development Bank and other foundations as private sector contributions, when in fact these groups should have been classified as public contributors. Resources coming from for-profit entities are private sector, whereas resources from nonprofit entities are public. Chemonics misclassified the amounts because USAID/Ecuador never provided Chemonics with clear definitions of public versus private leveraging.

These problems occurred because USAID does not have clear definitions and criteria for implementing partners to use when identifying and classifying leverage outside of formal GDA activities. Some USAID missions have required contractors to use USAID's leveraging definitions from guidance related to formal GDA programs; this guidance clearly specifies that contractors should count as leverage only new, nonpublic resources from the private sector and other nontraditional USAID partners. However, use of this guidance is only mandatory for formal GDA activities, which this is not. The revised results show more clearly that the program was unable to create strong private sector alliances as envisioned in the contract. Only 6.7 percent (\$420,000) of the \$6.3 million in leveraged resources came from the private sector.

Chemonics met its leveraging requirement. Still, because Chemonics did not report its leveraged resources accurately, the program is exaggerating its accomplishments. In particular, the reporting hid the fact that private sector leveraging, expected to be a major result of the program, was very small. Therefore, we make the following recommendations.

Recommendation 2. We recommend that USAID/Ecuador, in conjunction with Chemonics, (1) update the definition of the leverage indicator to include only resources leveraged during the life of the program, (2) classify nonprofits as public institutions and for-profits as private institutions, (3) disaggregate private and public resources leveraged when reporting, and (4) report revised figures in its final report; it should then document all four actions.

To ensure that future informal GDA programs that require leverage adopt clear, standard definitions, we also recommend that the Office of Acquisition and Assistance issue clarifying guidance.

Recommendation 3. We recommend that the Policy Division of the Office of Acquisition and Assistance update Automated Directives System Chapters 302 and 303 to include definitions and criteria for identifying and classifying leverage requirements in contracts and assistance agreements outside of formal Global Development Alliance activities.

EVALUATION OF MANAGEMENT COMMENTS

USAID/Ecuador agreed with Recommendations 1 and 2, and M/OAA/P agreed with Recommendation 3. Comments from the mission and M/OAA/P indicate they made management decisions on all three recommendations. Our evaluation of management comments follows.

Recommendation 1. USAID/Ecuador decided to document the challenges faced in improving livelihoods in its final report. It intended to complete the final report and upload it to the Development Experience Clearinghouse by July 31, 2014. We acknowledge the mission's management decision.

Recommendation 2. USAID/Ecuador decided to break down leverage information into four categories in its final report, which will be completed by July 31, 2014. The four categories will be (1) governmental not including *Socio Bosque*, (2) governmental meaning *Socio Bosque* only, (3) nongovernmental organizations, and (4) private for-profit organizations. We acknowledge the mission's management decision.

Recommendation 3. USAID's Policy Division of the Office of Acquisition and Assistance decided to revise ADS to distinguish between leverage and cost share, clarify regulations applicable to both terms, and provide criteria for differentiating between leverage and cost share by August 30, 2014. We acknowledge the mission's management decision.

SCOPE AND METHODOLOGY

Scope

RIG/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 in accordance with our audit objective. We believe that the evidence obtained provides that reasonable basis.

The purpose of this audit was to determine whether USAID/Ecuador's Sustainable Forests and Coasts Program was achieving its main goal of conserving biodiversity to benefit residents in coastal Ecuador and adjacent dry forests and wet tropical forests by establishing long-term partnerships with local organizations.

The mission awarded Chemonics a cost-plus-fixed-fee completion contract, which began on June 15, 2009, and was to end on June 14, 2014. As of December 31, 2013, the entire \$15.0 million had been obligated, and \$13.2 million had been spent. Additional funds were to be added to the program in its final months, bringing the total estimated costs to \$15.8 million. We tested the amount spent.

The audit covered activities that occurred from the start of the contract on June 15, 2009, through December 31, 2013—the first 3.5 years of the program. We reviewed applicable laws and regulations as well as USAID policies and procedures pertaining to the program, including ADS 203, 204, 253, 320, and 540; the Biodiversity Policy; Leverage Overview;⁸ and supplemental guidance.

In planning the audit, we identified and reviewed relevant controls that USAID/Ecuador used to manage the program and oversee its activities. These controls included Chemonics' quarterly and annual performance reports, performance management plans, and annual work plans. We also met with Chemonics to obtain status updates, discussed implementation issues, and conducted field visits to meet with stakeholders. In addition, the auditors examined the mission's portfolio review notes and its fiscal year 2013 annual self-assessment of management controls, which missions are required to perform to comply with the Federal Managers' Financial Integrity Act, to determine whether the assessment cited any relevant weaknesses.

The audit team conducted fieldwork from February 3 through February 21, 2014, in Quito and along the coast of Ecuador. We visited USAID/Ecuador and Chemonics' offices in Quito and three of the program's four intervention areas—the Chongon Colonche area, Guayas Province, and Reserva Marina Galera San Francisco, pictured in Appendix III.

Methodology

To answer the audit objective, we interviewed USAID/Ecuador's contracting officer's representative, the environment team leader, the mission environment officer, contract specialists, monitoring and evaluation specialists, the training adviser, and the TIP adviser. We reviewed the contract and its modifications, work plans, the performance management plan,

⁸ <http://inside.usaid.gov/idea/gp/leverage-overview>, accessed on June 5, 2014.

progress reports, financial reports, the midterm evaluation, and other documents. We interviewed Chemonics' chief of party, deputy chief of party for programming, the monitoring and evaluation specialist, and staff from three of the four regions.

Through these interviews and the review of program documentation, the audit team obtained an understanding of (1) the program's goals, (2) how performance indicators, targets, and baseline data were established to measure progress, (3) how the mission verified the quality of the data that Chemonics reported, (4) how the mission monitored program activities, and (5) whether the mission was aware of any allegations of fraud or other potential illegal acts or noncompliance with laws, regulations, and contract terms.

In addition, we performed the following audit tests:

- Reviewed and tested the performance indicators and targets to determine their appropriateness.
- Reviewed and tested the procedures the mission established to monitor and confirm the accuracy of the program's reported results.
- Documented and tested compliance with award requirements for leveraging funds, doing gender analysis, countering human trafficking, doing branding and marking, and mitigating environmental risk.

Together with USAID/Ecuador and Chemonics, we judgmentally selected various activities along the coast for field visits. Sample selection was based on factors including accessibility and diversity of activities. We conducted field visits to validate reported results to the extent possible. Since the testing and site selections were based on judgmental samples, the results and conclusions related to the analysis were limited to the items and areas tested, and cannot be projected to the entire population. We believe our substantive testing was sufficient to support the audit's findings.

MANAGEMENT COMMENTS

UNITED STATES GOVERNMENT

Memorandum

DATE: July 3, 2014

TO: Van Nguyen /s/, Regional Inspector General/San Salvador

FROM: Christopher Cushing, USAID/Ecuador Mission Director

SUBJECT: Comments to USAID/Ecuador's Sustainable Forests and Coasts Program
- Draft Audit Report No. 1-518-14-0XX-P, sent June 6, 2014

Thank you for giving USAID/Ecuador the opportunity to respond to the draft report of the Audit of USAID/Ecuador's Sustainable Forests and Coasts Program, sent to us on June 6, 2014. USAID/Ecuador appreciates the time and consideration that the audit team invested in preparing this report.

Below we have listed the three audit findings and recommendations. Following each recommendation are USAID/Ecuador's comments and suggestions on the draft audit report for your consideration.

Recommendation 1: We recommend that USAID/Ecuador document the challenges faced in improving livelihoods in its final evaluation report and upload the evaluation to the Development Experience Clearinghouse.

We will document the challenges faced in improving livelihoods in the final report for the project and upload this report to the Development Experience Clearinghouse. Please note that there will be no final evaluation for the project because of the closing of the project (June 14, 2014), as well as the closing of the USAID/Ecuador Mission (September 30, 2014), in response to the Government of Ecuador's moratorium on extending existing or beginning new activities. Please also note that the recommendation does not allege any USAID/Ecuador non-compliance with required submissions to the Development Experience Clearinghouse.

Recommendation 2: We recommend that USAID/Ecuador, in conjunction with Chemonics, (1) update the definition of the leverage indicator to include only resources leveraged during the life of the program, (2) classify nonprofits as public institutions and for-profits as private institutions, (3) disaggregate private and public resources leveraged when reporting, and (4) report revised figures in its final report; and document all four actions.

In the final report for the project, USAID/Ecuador staff will document revised leverage figures identifying resources leveraged during the life of the program. We will further break down these figures into four categories: (1) governmental (not including *Socio Bosque*); (2) governmental (*Socio Bosque* only); (3) private non-governmental private for-profit organizations. Please note that we will report *Socio Bosque* separately because it contributed significantly more than other governmental sources.

Recommendation 3: We recommend that the Policy Division of the Office of Acquisition and Assistance update Automated Directives System Chapters 302 and 303 to include clear definitions and criteria for identifying and classifying leverage requirements in contracts and assistance agreements outside of formal Global Development Alliance activities.

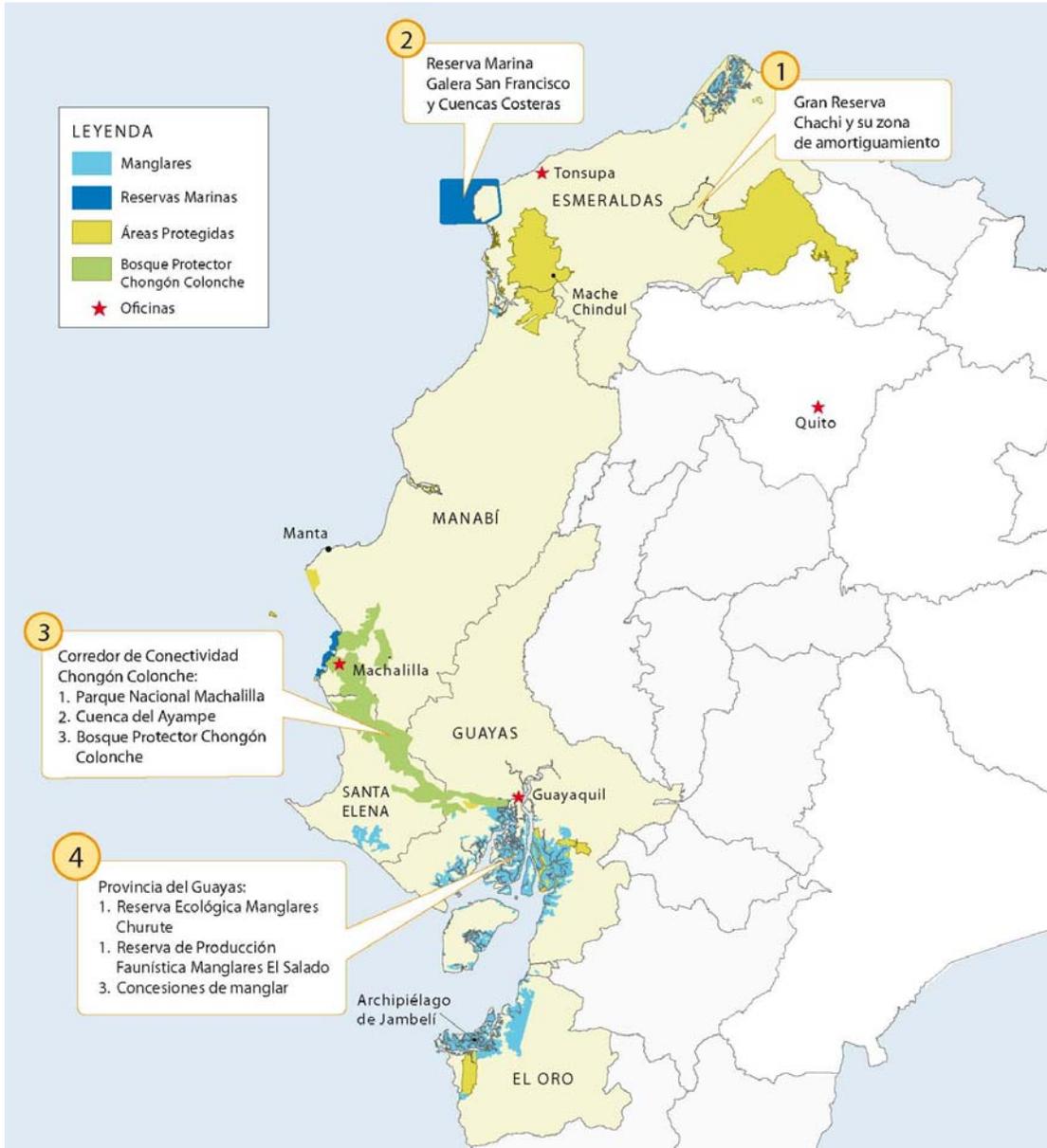
This recommendation to amend the Automated Directives System (ADS) sections 302 and 303 is not within the manageable control of USAID/Ecuador. Revisions or additions to the ADS are within the sole purview of USAID/Washington. We note that the recommendation does not allege any USAID/Ecuador non-compliance with existing requirements for leverage. Based on the above, we ask that Recommendation #3 be removed from the final report or that you accept this response as final Mission action to close out this recommendation.

Management comments on Recommendation 3 received by e-mail July 16, 2004, on behalf of Marcelle Wijesinghe, Division Chief, M/OAA/P:

By August 30, M/OAA/P will process revisions to the Automated Directives System 303.3.10.2 that will (1) clearly distinguish between leverage and cost share with clear definitions, (2) clarify the regulatory environment for both cost share and leverage, (3) provide criteria for identifying leverage as distinct from cost share and the applicability, if any, of leverage to assistance instruments.

Since the ADS process takes some time to incorporate changes into any of the chapters, we need time for that process and also to check what effect, if any, that this change will have on any related ADS chapters.

Program Areas in Ecuador



Source: USAID Work Plan.

U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Avenue, NW
Washington, DC 20523
Tel: 202-712-1150
Fax: 202-216-3047
<http://oig.usaid.gov>