OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/SRI LANKA'S BIZ PLUS PROGRAM

AUDIT REPORT NO. 5-383-14-005-P
SEPTEMBER 8, 2014

MANILA, PHILIPPINES

Office of Inspector General

September 8, 2014

MEMORANDUM

TO: USAID/Sri Lanka Mission Director, Sherry Carlin

FROM: Regional Inspector General/Manila, Matthew Rathgeber /s/

SUBJECT: Audit of USAID/Sri Lanka's Biz Plus Program (Report No. 5-383-14-005-P)

This memorandum transmits our final report on the subject audit. In finalizing the audit report, we considered your comments on the draft report and have included them in Appendix II.

This report contains six recommendations to assist the mission in improving certain aspects of the Biz Plus Program. According to the information you provided in response to the draft report, the mission has taken final action on Recommendations 1, 3, 4, and 5, and made management decisions on Recommendations 2 and 6. Please provide the Audit Performance and Compliance Division of USAID's Office of the Chief Financial Officer with evidence of final action to close the recommendations with management decisions.

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

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SUMMARY OF RESULTS

After 25 years of ethnic conflict, Sri Lanka has made economic growth a top priority. It is encouraging small businesses in rural areas, especially in the Northern and Eastern Provinces, where fighting did the most damage. By assisting entrepreneurs in these areas (shown in the map below), the government hopes to increase jobs and promote stability.

Source: The University of Texas at Austin. — http://www.lib.utexas.edu/maps/sri_lanka.html

To help, in September 2011 USAID/Sri Lanka awarded Volunteers for Economic Growth Alliance (VEGA) a $24.0 million, 4-year cooperative agreement to implement the Biz Plus Program. VEGA is a consortium of U.S.-based nonprofit organizations that specialize in promoting economic growth in developing and transitional countries; Land O'Lakes International Development leads the consortium. The program's main objective is to increase jobs and generate income in Northern and Eastern Provinces through grants for enterprise development.

In November 2013, the mission amended the cooperative agreement to reduce estimated costs from $24.0 million to $17.6 million by shortening the end date 3 months (ending on June 30, 2015, instead of September 30, 2015). It did so after USAID's Asia Bureau instructed the mission to shift the funds to a new livelihood development project. The amendment also reduced the number of grants to be issued, the number of jobs to be created, and the amount of increased income to be generated. As of September 30, 2013, the mission had obligated approximately $15.9 million and expended $5.3 million for the program, which awards grants ranging from $50,000 to $500,000.

The program began with three components: (1) issuing grants to enterprises, (2) providing technical assistance to grant recipients and associated institutions, and (3) improving business enterprise in the region. Its goal was to strengthen small businesses by creating 5,000 jobs that would generate an increase in income of approximately $4.0 million annually for the combined vulnerable households headed by the jobholders. The November 2013 amendment eliminated the third component.

Before it shrank the program, USAID expanded it. The program began in six districts in Sri Lanka's Northern and Eastern Provinces: Ampara, Batticaloa, Jaffna, Kilinochchi, Trincomalee, and Vavuniya. No activities had started in Mullaitivu and Mannar. On July 26, 2012, the mission decided to include Uva, North Central, and North Western Provinces, adjacent to the Northern and Eastern Provinces. On July 25, 2013, Land O'Lakes was specifically instructed to focus efforts in the North Central Province.

The Regional Inspector General/Manila (RIG/Manila) conducted this audit to determine whether the program was achieving its main objectives. The program had made some progress through issuing grants to new and existing enterprises and providing technical assistance to grant applicants. As of September 2013, the program had approved 21 grants for business expansion and provided technical assistance to 35 more business owners awaiting grant approval. Small businesses assisted by the program expressed their appreciation, as noted below.

Technical Assistance Met Small Businesses' Needs. Business owners found technical assistance with the grant application helpful because they had limited capacity in developing concept papers and business plans. The program offered training on writing grant proposals as well as on managing finances, human resources, and database records. All 17 grantees interviewed provided positive feedback.

Business Expansion Created Jobs. Although 60 percent of the grants were approved shortly before the audit, feedback from 12 grantees that had received grants earlier and had time to put funds to use was positive. For example, Land O'Lakes is cofunding the building expansion and procured sewing and embroidery machines, motorcycles, furniture, computers and accessories, and raw materials for garment production at a garment factory under the grant. The following photo shows women working in the garment factory with some of the sewing machines purchased under Biz Plus. According to the owner, the business's lack of capital had constrained expansion. With the grant and technical assistance in funds management from the program, the company was able to create more jobs and hire more women from the region.

Despite these contributions, the program had achieved less than 2 percent of its performance targets for job creation and income generation. Specifically, the program had created only 190 jobs (1.9 percent of the target) and generated approximately $140,000 (0.5 percent of the target) in additional income. It underperformed for reasons including the following:

- The program fell behind on awarding grants (page 5). As of September 30, 2013, Land O'Lakes had issued 21 grants, falling short of the Year 2 target by 14. The majority of the grantees, mostly small and medium-sized enterprises, lacked the capacity to complete the application process. Land O' Lakes encountered delays in procurement of machines and equipment for grantees that received funding, and reducing the budget cut further slowed implementation.

Women work in a garment factory in Vavuniya, Northern Province. (Photo by RIG/Manila, November 26, 2013)

- Job creation targets for some grantees were unrealistic (page 6). None of the grants awarded had achieved their targets for jobs created and income generated.

- The implementer reported the incorrect value of resources leveraged[1] (page 8). During the second year, the program reported $516,872 in leveraged resources; however, the reported amount came from grantees' cost-sharing contributions, which are non-federal funds grantees are responsible to contribute as part of the agreement. .

The report recommends that USAID/Sri Lanka:

1. Direct Land O'Lakes to (1) document its strategy for the rest of the program and (2) work with each grantee to implement a work plan, taking into account its achievements, the status of activities, and the funding remaining, for maximizing impact (page 6).

2. Require Land O'Lakes to adjust targets for the number of jobs to be created by all grantees (page 8).

3. Direct Land O'Lakes to evaluate the accomplishments of all grants and the reasonableness and validity of the business idea in pending grant proposals to confirm that the grants comply with the program objective (page 8).

[1] Nonfederal funds raised by grantees and from other sources during the life of the program.

4. Conduct a cost-benefit analysis to determine if the program should continue (page 8).

5. Require Land O'Lakes to implement a plan to comply with the agreement's leveraging requirement (page 9).

6. Require Land O'Lakes to review and correct the reported cost-share and leveraged amounts to comply with agreement requirements (page 9).

A detailed discussion of the audit findings appears in the following section. The scope and methodology are described in Appendix I. USAID/Sri Lanka's written comments on the draft are included in Appendix II. Our evaluation of these comments is on page 10.

AUDIT FINDINGS

Program Fell Behind on Awarding Grants

According to the Biz Plus work plan, Land O'Lakes would develop a list of potential participants (enterprises) in the program during the first year and award 60 grants during the first 2 years. According to the mission, establishing the majority of grants up front was necessary to give grantees enough time to carry out business expansion activities.

The program planned to award 60 grants during the program, including the 40 required in the first 2 years of implementation. Yet the program fell short, even when the November 2013 modification reduced the targeted number of grants from 60 to 35. As of September 2013, the program had approved only 21 grant applications. Approving grants has taken much longer than expected, for the following reasons.

Inexperienced Grantees. Most grant applicants needed technical assistance to comply with the application requirements. According to the chief of party, technical assistance was planned to take 4 to 6 weeks, but because most grantees were not familiar with assembling the required documents—including copies of financial documents; proof of compliance with all laws and regulations regarding employment and taxes; environmental licenses; building permits; and a business plan—assistance lasted an average of 6 to 9 months. Furthermore, at the start of the program, the implementer did not have enough staff to review the grant application documents. On July 26, 2012, the mission approved a modification to increase the number of skilled staff to help process applications.

Procurement Delays. The Government of Sri Lanka exempted USAID/Sri Lanka's Biz Plus program from the payment of Sri Lanka's 12 percent value added tax (VAT).[2] To take advantage of this exemption when procuring machines and equipment, Land O'Lakes must provide vendors a copy of the VAT exemption letter. However, the Sri Lankan Ministry of Economic Development delayed issuing the VAT exemption to grantees that procured machinery and equipment. In most cases, the ministry took nearly 6 months to approve the exemptions. Because of the VAT exemption delays and delays in construction of its factory, one business took more than a year to begin operations after its grant had been approved.

According to the mission, the ministry did not act promptly because officials there and elsewhere in the government were dissatisfied with USAID's choice of regions for program implementation. On July 25, 2013, the mission decided to include grant applicants from North Central Province. Since then, both the Ministry of Economic Development and the Ministry of Finance have been more supportive of the Biz Plus Program. In addition, relationships with other ministries are good—especially with the Ministry of Industry and Commerce, responsible for promoting regional expansion of business activities within Sri Lanka. Grantee businesses are receiving support from the Ministry of Industry and Commerce registering their businesses to obtain VAT exemptions quickly.

[2] According to *Tax Updates 2013*, by a Sri Lankan accounting firm (http://www.bdo.lk/wp-content/uploads/2013/11/Tax-Updates_2013.pdf) exemption from the value added tax of 12 percent in Sri Lanka is provided to diplomatic organizations.

Funding Cut. According to the implementer, as of June 30, 2013, 22 business enterprises were on track to receive grants by September 30, 2013. However, on August 23, 2013, the mission announced that total funding for the program would be reduced by between $6.0 million and $8.0 million. Weeks passed before the program knew the exact amount of the budget reduction and the amount of funding available for additional grants. Hence, Land O' Lakes could not award any new grants for more than a month.

Because of the delays, the program has not achieved its targets on job creation and income generation and its impact and sustainability may suffer. To get the program back on track, we make the following recommendations.

> ***Recommendation 1****. We recommend that USAID/Sri Lanka direct Land O'Lakes to (1) document its strategy for implementing the Biz Plus Program during its remaining period and (2) work with each grantee to implement a work plan, taking into account its achievements, the status of activities, and the funding remaining, to achieve the program's intended results and maximize its impact.*

Job Creation Targets for Some Grantees Were Unrealistic

According to the cooperative agreement, grants should generate at least 144 jobs per $100,000 of grant funding. The grant agreements, therefore, require each grantee to create a certain number of new jobs. As shown in the table below, as of September 2013 the program reported jobs and income far below the targets.

Job Creation and Income Generation as of September 30, 2013 (unaudited)

Indicator	End-of-Program Target*	Target by Year 2	Achievements by Year 2	% Achieved
Number of jobs created	10,000	2,000	190	1.9
Increase in annual household income†	$30.0 million	$6.0 million†	$140,054	0.5

* The November 2013 modification reduced the targets to 5,000 jobs and a $4.0 million increase in annual income.

† This indicator measures the average increase in annual income for the 10,000 households represented by the new jobholders. Therefore, average income for each household is $600 = $6.0 million/10,000 households.

The program fell short not only because of the numerous delays detailed in the previous finding, but also because the targets established for some grantees were not realistic, as discussed in the examples below. Appendix III lists the 21 grants with their targets and status as of September 30, 2013.

Ice Production Plant. This grant to an ice factory was the first awarded, in early 2012. The grant was expected to create 80 new jobs; however, as of September 30, 2013, it had created only 37, or 46 percent of the number expected. Currently, the ice factory (shown in the following photo) is operating at full capacity, and the grantee does not need to hire any more workers.

According to the grant agreement, the grantee planned to hire workers to distribute ice to three outlets that the grantee planned to build. These outlets would have made ice accessible to fishers, who use ice to preserve the quality of their catch and sell the fish at higher prices.

Workers load ice blocks at an ice production plant in Jaffna, Northern Province. (Photo by RIG/Manila, November 27, 2013)

However, fish traders are now purchasing ice in bulk at the plant, leaving no more supply for the outlets and eliminating the need to build the outlets and hire ice distributors. According to the grantee, his business plan did not anticipate bulk purchasing. However, the owner acknowledges his obligation to build the three distribution centers and hire workers resulting from the expansion, as stated in the grant. The owner's intent is to comply with the grant agreement, even if doing so adds no value to his business.

Land O'Lakes did not properly assess how investment opportunities would add value to businesses. Land O'Lakes also did not thoroughly evaluate whether grantees' business plans contained the elements the cooperative agreement required in every business plan to ensure smooth implementation of activities and long-term sustainability of the grantees business. Hence, the program did not identify the gap in the ice production plant's business plan stemming from changes in the business environment.

Biomass Briquettes Manufacturing Company. This grantee recycles sawdust and wood chips to produce biomass briquettes,[3] primarily for industrial use. Currently, the grantee's two factories use mainly sawdust and water hyacinth as raw materials. The factory that auditors visited uses sawdust and wood clippings that are waste products from a local furniture producer. The program recently awarded this business owner a grant to build a new factory that is

[3] According to a 1996 publication by P.D. Grover & S.K. Mishra for the Food and Agriculture Organization of the United Nations (http://www.fao.org/docrep/006/ad579e/ad579e00.pdf), biomass briquettes are a renewable energy substitute for coal and charcoal. They are used for cooking and to heat small industrial boilers to produce electricity from steam.

expected to generate 72 new jobs. According to the business owner, the new factory will be roughly the same size as the two existing factories.

Land O'Lakes explained that the new factory was designed with a business model different from the existing factories. The new factory will mainly use plant waste, such as rice husks, collected from farms; thus, it will require the hiring of collectors. The deputy chief of party also explained that before the grant was issued, the program did due diligence and found that the briquette factory would be able to deliver the target number of jobs. However, given the large difference between the number of employees in the existing plants—the company employs an average of 33 workers at each existing plant—and the jobs projected to be created in the new plant (roughly twice the number), the projection may not be realistic.

Although Land O'Lakes has developed an investment diagnostic tool to evaluate prospective grantees and grant opportunities, it did not use the tool to analyze the production capacity of each grantee, including its business idea and past performance to make sure it complies with the program objective.

The number of jobs created and income generated are the core deliverables of the program. Failure of the grantees to meet these targets will affect the achievement of two other objectives—increasing gross household income and increasing the number of vulnerable households directly benefiting from assistance. With 18 months remaining and the majority of the grantees still in the early stages of implementation, the program needs to reassess the targets for realism.

> ***Recommendation 2***. *We recommend that USAID/Sri Lanka require Land O'Lakes to adjust to realistic levels targets for the number of jobs to be created by all grantees.*
>
> ***Recommendation 3*****.** *We recommend that USAID/Sri Lanka direct Land O'Lakes to perform an evaluation of all grants covering the remainder of the Biz Plus Program, look at accomplishments, and analyze the reasonableness and validity of the business idea in the grant proposals to confirm the grants comply with the program objective.*
>
> ***Recommendation 4*****.** *We recommend that USAID/Sri Lanka conduct a cost-benefit analysis of the Biz Plus Program to determine whether it should continue.*

Implementer Reported Incorrect Value of Resources Leveraged

The cooperative agreement requires Land O'Lakes to make a cost-sharing contribution equal to at least 12 percent ($2.9 million) of the USAID contribution and to leverage another $13.0 million from grant recipients and program partners. The cooperative agreement and the performance monitoring plan made this distinction between the two indicators: cost share includes cash or in-kind resources from award recipients that will complement program goals, whereas leveraged resources represent non-USAID or other non-U.S. federal resources that are expected to be applied to an enterprise as a result of an alliance or public-private partnership.

However, Land O'Lakes tracked only cost-share contributions and made no distinction between cost share and leveraged resources in program records. In the second year of program implementation, it reported as leveraged resources $516,872 that should have been classified as cost share. Land O'Lakes explained that once the target on the cost-share contributions had been reached in the second year, the program began counting any additional cost-share amount as leveraged resources. In addition, the mission was aware of the methodology used by Land O'Lakes to report on cost sharing and did not object to it. However, this practice was inconsistent with the cooperative agreement, which provided separate requirements, and the performance monitoring plan, which differentiated between the two.

Information about contributions through cost sharing and leveraging gives mission officials an important tool in determining how to focus USAID resources to achieve the greatest impact. Without proper reporting of leveraged resources, which should be significantly higher at $13.0 million than the cost-share requirement of $2.9 million, the mission cannot determine whether the program is making the desired impact. Leveraged resources from grantees also demonstrate that they take some ownership of the program and will help sustain it.

> ***Recommendation 5.*** *We recommend that USAID/Sri Lanka work with Land O'Lakes to implement a plan to comply with the leveraging requirement of the agreement.*

> ***Recommendation 6.*** *We recommend that USAID/Sri Lanka require Land O'Lakes to review and correct the reported cost-sharing and leveraging amounts to comply with the agreement requirements.*

EVALUATION OF MANAGEMENT COMMENTS

In its comments on the draft report, USAID/Sri Lanka agreed with five of the six recommendations. Having evaluated the comments and supporting documentation, we acknowledge management decisions on Recommendations 2 and 6 and final action on Recommendations 1, 3, 4, and 5. The mission also made some suggested wording changes, and where we agreed, we made them. A detailed evaluation of management comments follows.

Recommendation 1. The mission decided to (1) document its strategy for implementing the Biz Plus Program during its remaining period and (2) work with each grantee to implement a work plan, taking into account its achievements to date, the current status of activities, and the remaining funding available, to achieve the program's intended results and maximize its impact.. On January 10, 2014, the mission approved the program's Performance Monitoring Plan, which documents its implementation strategy for the remainder of the program. Land O'Lakes is conducting more frequent site visits as it continues to use the Achievement Tool document it has developed to monitor grantee progress against its work plan. The mission is also closely monitoring grantee progress and accomplishments through regular site visits. We acknowledge the mission's management decision and final action on Recommendation 1.

Recommendation 2. The mission decided to require Land O'Lakes to adjust targets for the number of jobs to be created by all grantees. It instructed Land O'Lakes to evaluate each grant activity to determine whether the progress toward targets meets established timelines. If necessary, timelines and job targets will be adjusted. The evaluation was to be completed by July 31, 2014. We acknowledge the mission's management decision. Final action will be taken when the mission completes its evaluation of the job targets.

Although the mission agreed with the recommendation, it found our assessment in Appendix III misleading. Mission officials stated the table should include a column that indicates time elapsed since grant award. Mission officials also stated it is impractical to expect the small businesses awarded grants to create jobs in a short time.

Our analysis is based on the information provided in each grant, including the required time frame to recruit staff. RIG/Manila did not include the elapsed time for each grantee in the table because most of the grants had been active for at least 9 months as of September 2013. Rather, we reviewed each grant to determine the required time frame for hiring staff. The average time for the 21 grants is 6 to 9 months from the effective date of the grant. The grantee accepted this time frame for job creation as a condition of receiving the grant. A food processing plant, for example, was required to hire 53 employees within 6 months from June 2013, when its grant was approved. As of December 2013, it had not hired any staff.

Recommendation 3. The mission decided to direct Land O'Lakes to perform an evaluation of all grants active or pending, look at their accomplishments, and analyze the reasonableness and validity of the business idea in the grant proposals to confirm that the grants comply with the program objective. It is working with the implementer to use the tool developed to evaluate all grants' progress and to confirm that they comply with the program objective. Further Land O'Lakes conducted due diligence to assess the reasonableness and validity of each grantee's business plan, confirming that the grants comply with the program objective. The mission stated in comments that it is satisfied with the process that Land O'Lakes adopted to evaluate business proposals. We acknowledge the mission's management decision and final action on Recommendation 3.

Recommendation 4. The mission disagreed with the recommendation to conduct a cost analysis to determine if the program should continue. According to the mission's comments, the most recent program data indicate that the program is making progress in achieving its results. The mission stated in comments that it believes the program should continue. Given the information provided, we acknowledge the mission's management decision and final action on Recommendation 4.

Recommendation 5. The mission decided to work with Land O'Lakes to implement a plan to comply with the agreement's leveraging requirement. On May 19, 2014, VEGA submitted a plan to the mission defining what should be reported as cost share and leveraged resources. The mission approved the plan and signed Modification 7 of the cooperative agreement incorporated the definitions. We acknowledge the mission's management decision and final action on Recommendation 5.

Recommendation 6. The mission decided to require Land O'Lakes to review and correct the reported cost-sharing and leveraging amounts to comply with the agreement requirements. It approved VEGA's request to adjust the cost sharing and leveraging amounts. VEGA made the adjustment following Modification 7 of the cooperative agreement. The mission stated that the figures would be reported in the quarterly report for April–June 2014, due to USAID by July 30, 2014, as well as in the monthly financial report for July 2014, due in mid-August. We acknowledge the mission's management decision.

USAID/Sri Lanka acknowledged the inconsistency between the language in its performance monitoring plan and in the cooperative agreement on what should be reported as cost share and leveraged resources. Upon further review of the agreement language, the mission revised the budget on cost share and leveraged resources, changing cost share from $2,867,292 to $332,588 and leveraged resources from $12,960,000 to $15,298,305.

SCOPE AND METHODOLOGY

Scope

RIG/Manila 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 the audit was to determine whether the program was achieving its main objectives: to increase jobs and generate income in Northern and Eastern Sri Lanka through enterprise development.

According to the mission, as of September 30, 2013, it had obligated approximately $15.9 million for the program and disbursed $5.3 million. The total estimated cost of the program has been subsequently reduced from $24.0 million to $17.6 million. Because this was a performance audit, which focused on program implementation rather than financial transactions, the audit did not include a financial review of the $5.3 million disbursed. The audit covered selected activities from the program’s inception through September 30, 2013.

We assessed the following significant internal controls that USAID/Sri Lanka used to monitor project activities: the implementer’s quarterly and annual progress reports, the performance monitoring and evaluation plan, and reports of meetings between mission officials and Land O’Lakes. We also assessed monitoring conducted by the implementer of grantees’ activities and site visits performed by the mission to validate program achievements. Additionally, we examined the mission’s fiscal year 2013 annual self-assessment of management controls, which the mission is required to perform to comply with the Federal Managers’ Financial Integrity Act of 1982, to check whether the assessment cited any relevant weaknesses.

Audit fieldwork was performed at the USAID/Sri Lanka office in Colombo, the implementer’s offices in Colombo and Batticaloa, and the offices and factories of grantees in Northern and Eastern Provinces in the district towns of Ampara, Batticaloa, Jaffna, Kilinochchi, Trincomalee, and Vavuniya. The audit team visited activities funded under 17 (81 percent) of the 21 grants. We judgmentally selected these 17 grants based on the location and value of each grant, with a total value of $3.5 million. Audit fieldwork was conducted from November 18 to December 13, 2013.

Methodology

To determine whether the program was achieving its main objectives, we reviewed relevant background documents—the cooperative agreement and modifications, annual work plans, site visit documents, and other records—to gain an understanding of the program and its activities. In addition, we examined the implementer’s quarterly and annual progress reports to ascertain the status of activities as of September 30, 2013. The team also interviewed personnel at USAID/Sri Lanka, implementer officials, and 17 of the program’s grantees.

In addition to reviewing records on file at USAID/Sri Lanka and the implementer's main office in Colombo and satellite office in Batticaloa, the audit team traveled to six districts in Northern and Eastern Provinces to visit selected activity sites.

Audit work during these site visits included interviewing grantees and beneficiaries to solicit feedback on the program's activities and assess the impact of the interventions on job creation and household income. To the extent possible, we verified the planned deliverables and determined the extent to which they had been achieved.

In validating the program's reported achievements, the audit team reviewed all 20 indicators and tested data reported on them from the program's inception through September 30, 2013. This involved comparing the reported results with supporting records to determine whether the reported data were accurate and reliable. We established a materiality threshold of 90 percent in assessing the program's progress toward its overall goals and a threshold of 15 percent for errors in reported data reliability. To make acceptable progress, the program needed work plans that adequately reflected its goals, and the implementer needed to have achieved at least 90 percent of its planned outputs during the audit period and reported results are less than the 15 present error threshold if compared with actual results. Because we used a judgmental sample, results and overall conclusions are limited to the items tested and cannot be projected to the entire audit universe. As part of this review, we also examined a data quality assessment that USAID/Sri Lanka completed.

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MANAGEMENT COMMENTS

USAID | SRI LANKA
FROM THE AMERICAN PEOPLE

MEMORANDUM

TO: **Matthew Rathgeber, Regional Inspector General / Manila**

THRU: Sherry F. Carlin, Mission Director, USAID / Sri Lanka

FROM: Russell Bauer, Acting Director, Economic Growth Office

DATE: **July 23, 2014**

SUBJECT: USAID/Sri Lanka comments on the audit of the Mission's VEGA/BIZ+ Program (Report No. 5-383-14-XXX-P)

Background:

This memorandum is USAID/Sri Lanka Mission's formal response to the Regional Inspector General's (RIG) draft audit report of the VEGA/BIZ+ Program – Report No. 5-383-14-XXX-P. The response is structured around the six recommendations, followed by the status of corrective actions taken, or to be taken, in the future. The Mission has also provided some clarifications, additional information, and factual corrections in relation to the findings and background information presented in the report.

The Mission concurs with the three areas of concern noted by the auditors: Delay in Awarding Grants, Establishment of [Realistic] Grantee Job Creation Target, and Reporting of Leverage. All three points had been recognized as implementation challenges both by the Mission and BIZ+ management, and were under discussion in various contexts with the USAID/Sri Lanka Assistance Officer's Representative (AOR) before the arrival of the auditors. As a result of these proactive measures, almost all of the suggested corrective actions were already in development and/or were being implemented at the time of the audit. Further, as explained below, corrective actions related to five of the six recommendations have been completed as of the submission of this response. The Mission does not accept recommendation No 4: Conduct a cost-benefit analysis to determine if the program should continue.

Comments on Summary of Results Section
Page 1, Paragraph 6:

USAID/Sri Lanka disagrees with the statement that BIZ+ is not achieving its main objectives. The auditor's determination of this conclusion is premature, and does not take into account a number of important and necessary factors including the expectations outlined in the Cooperative Agreement concerning the timing of implementation and results, the time horizon required for business investment activities to take place and produce the intended results, as well as the fact that the job targets included in each grant award clearly show that the program is on track to achieve its targets. Unforeseen institutional and procedural constraints and lack of capacity of businesses in post-conflict regions also contributed towards the delay in implementation.

In the Cooperative Agreement's Program Description there is no hard requirement for all grants to be awarded by the end of Year 2. In fact, this section explains that awareness building, application review, due diligence, and building capacity of grantees to develop the grants (e.g. business plans) would happen during Years 1-2. Further, it says that grants would be reviewed on a rolling basis, which is what has happened. It also goes on to say that 70% of grant funds would be dispersed in Years 2 and 3. All of this indicates a rolling basis on which grants would be awarded.

When it comes to capturing results, this is the first of this type program to be implemented in Sri Lanka. It was only after partnership development and the beginning of the review of business plans did BIZ+ and USAID fully appreciate the time horizon factor. As such, in yearly Performance Monitoring Plan (PMP) updates, the timing of achievement of results has been shifted to a new timeframe to take these on the ground realities into account. BIZ+ grantee businesses are making progress and achieving results at the same rate and time horizon compared to other small and medium enterprises in Sri Lanka. This proves the theory, which is applicable worldwide, that it does take time to carry out investments and then reap the benefits from them. This is very true in post-conflict regions where unforeseen institutional and procedural constraints and lack of capacity of businesses delay implementation of development programs.

Page1-3:
USAID/Sri Lanka further clarifies the following information in several parts of this section.

- 3rd paragraph: Should read grants ranging from $50,000 to $500,000
- 5th paragraph: The program began in 8 (eight) districts in the Northern and Eastern Provinces. In addition to those mentioned in the report, Mullaitivu and Mannar Districts in the Northern Province should be included.
- 5th paragraph: There was a Modification No. 1 to the Cooperative Agreement in July 26, 2012 to change the program's geographic focus from the North and the East to include Uva, North Central and North Western Provinces. On July 25, 2013, BIZ+ was specifically instructed to focus efforts on the North Central Province. This late change caused several challenges to program implementation namely when it came to availability of grant funding.
- 7th paragraph – By the end of Project Year 2 in September 2013, BIZ+ had provided technical assistance to over 200 business owners and individuals during the awareness building, application review process, and grant implementation. It is not clear where the RIG obtained the figure of 35.

RIG RECOMMENDATION No. 1:

Direct Land O'Lakes to

(1) document its strategy for implementing the Biz Plus Program during its remaining period and
(2) Work with each grantee to implement a work plan, taking into account its achievements to date, current status of activities, and remaining funding available, to achieve the program's intended results and maximize its impact.

USAID/SRI LANKA'S RESPONSE:

Mission concurs with this recommendation and the corrective actions proposed by the auditors. The actions have been implemented.

Corrective Action No.1:
The auditors recommend USAID to direct BIZ+ "to document its strategy for the implementation of the Biz Plus Program during its remaining period." This action has been completed.

Clarifying information:
Per Section A.5, Reporting and Evaluation, of the Cooperative Agreement, the annual update to the BIZ+ Performance Management Plan (PMP) (which is comprised of a program Work Plan and the Performance Monitoring Plan), was submitted to USAID on 13 December 2013, during the time the Auditors were in country. The PMP clearly documents the program's implementation strategy. The Year 3 annual PMP update was approved by the AOR on 10 January 2014, in which USAID has reviewed and accepted BIZ+'s implementation strategy for the remaining period. The latest approved PMP update is included in Appendix A.

Section A.5 requires that yearly PMP updates should be presented by BIZ+ to USAID "30 days before each subsequent 12 month contract period thereafter." The submission of the annual update to BIZ+'s PMP between Years 2 and 3 was delayed due to an extensive Modification to the Cooperative Agreement that was triggered by a Total Estimated Cost (TEC) reduction from $24 million to $17.6 million which was announced on September 11, 2013. Verbal notification of the TEC reduction had been provided by USAID in August 2014. Well before the due date, it was agreed between VEGA and USAID that it was necessary to first reassess the implementation strategy after reworking the budget, making decisions on priority implementation areas, as well as scaling down the achievable results commensurate to a largely reduced budget. Within two weeks of the submission of the Modification request BIZ+ submitted its annual PMP update taking into account a reduced budget, new result targets, as well as other realities and lessons learned during the previous year's implementation efforts. The Agreement Officer's concurrence was obtained to submit the PMP after the due date.

Finally, Section A.5 also states that the PMP "is intended to be a living document" and PMP updates "…should have clarifying notes showing any program adjustments and changes to previous PMP submittals…"and "… discuss and take into account any implementation lessons learned in the previous 12 month period of program implementation…" To date, BIZ+ and USAID have consistently adhered to the spirit of Section A.5, which provides for ongoing and active dialogue about program implementation challenges. The Auditors have cited a number of unforeseen challenges which have been duly addressed through frequent interaction between the AOR and BIZ+ Management, and which is reflected through PMP updates. All PMP updates have been closely reviewed and approved by USAID.

Corrective Action No. 2:
The auditors have recommended that BIZ+, "work with each grantee to implement a work plan taking into account its achievements to date, current status of activities, and remaining funding for achieving the program's intended results and maximizing the impact." This action has been initiated and is ongoing.

Clarifying information:
Each of the 36 BIZ+ sub awards currently in implementation contains a detailed work plan, including a schedule of milestones. These work plans are carefully reviewed and approved by USAID upon the request for sub-award approval made by BIZ+. Thus, all BIZ+ grantees are, and have been since the start of the program, working against detailed work plans and timelines. In order to ensure that grantees are making appropriate progress towards achieving their results, BIZ+ team members work closely with each grantee to ensure that they adhere to the work plan and milestone due dates. It is true that some BIZ+ grantees fell behind on milestone due dates at certain points in time during sub-award implementation. This is not uncommon in an environment whereby capacity of the business is being built at the same time as investments are being made. However, the experience to date demonstrates that the grantees have achieved some milestones ahead of time and achieved all milestones well within the period of performance of the sub-award. An example of this situation is included in Appendix B, an Achievement Tool Monthly Report as of April 2014 for a garment factory in the north which the OIG visited.

To ensure BIZ+ tracked milestones and addressed situations when grantees fell behind in meeting milestones, BIZ+ developed a comprehensive "Achievement Tool" in August 2013 with the intention of more efficiently monitoring grantee progress, especially given the large volume of grants and corresponding milestones. This Achievement Tool, which is a document that lists all activities, milestones, and conditions to be met under each grant, is specially tailored to each sub-award, taking into account the grantee's specific activities, special conditions, and targets. The Achievement Tool incorporates a Gantt chart showing all milestones and provides for documentation of actions based on site visits conducted. Using the Achievement Tool, BIZ+ actively monitors grantee progress and accomplishments on a grant by grant basis. The Achievement Tool includes a report format which is updated monthly by BIZ+ Enterprise Development Officers, reviewed and analyzed by BIZ+ Management, and is filed in the sub-award file. Frequent grantee site visits – a minimum of one per month, but most often 2-3 per month – are conducted by various BIZ+ team members including management. When delays are observed, or unexpected challenges encountered, the enterprise development and grant team members meet with management to discuss the reasons for the delay. Meetings with grantee owners are also arranged. The team then provides extra follow up and support to the grantee to help find solutions and expedite progress. If BIZ+ encounters a significant challenge which leads to the need to revise the timing of grant activities, in content or in due date, or to revise budget lines, then BIZ+ will issue a modification to the sub-award agreement.

Finally, USAID/Sri Lanka has also been closely monitoring the progress of BIZ+ implementation by more frequent reporting and site visits. A weekly status update, including a tracker of all grants, is provided to the AOR each Monday morning. This practice of regular updates has been in place since 2012. A sample BIZ+ weekly update – one sent on 30 September 2013 – is included in Appendix C. Using this update, it has been possible for USAID to closely follow the progress of all grants. The grant tracker provides details of all business applications received as well as their award status. Further, it presents the jobs and contribution targets for each grantee so that USAID can see the program's progress towards meeting the results.

Finally, the Mission AOR also routinely visits BIZ+ grantees, often 2-3 times per quarter, and holds a regular bi-weekly meeting with the BIZ+ Chief of Party. Therefore, all parties are monitoring and addressing implementation progress and challenges on a regular basis.

In sum, the combination of frequent site visits by BIZ+ and USAID, and the use of the Achievement Tool, allows BIZ+ to closely monitor grantee progress against their work plans and towards achieving their results.

USAID/Sri Lanka is providing additional information which may be useful to the RIG to have a more specific chronological listing of several important events and challenges that BIZ+ faced, which directly affected the program's ability to award and implement grants quickly, which has also affected the rate at which grantee businesses can complete their investment activities. Specifically, the points below provide additional information on:

1. The evolution and growth of the size of the BIZ+ team, which was largely inadequate for the size and scope of the program at the beginning;
2. The gradual reduction in grant funding available to accommodate a larger team; and
3. The sequencing of events leading up to the period of July – October 2013 when BIZ+ was nearing completion of award of its grants.

On 30 November 2011 the original Performance Management Plan was submitted to USAID with a target of 50 investment grants and 25 service grants. There are two separate types of grants indicators for this target. It is important to make a distinction between these two types of grants because the figures alluded to in this section (pages 4-5) refer to investment grants only. The AOR at the time, Daniel Lee, instructed BIZ+ to change the investment grant total to 60 and reduce the service grant total to 20. BIZ+ complied with this request. The PMP was approved by the AOR on 23 February 2012.

On 10 August 2012 BIZ+ received Modification No. 1 which formally provided for the program to work in provinces bordering the North and the East. This same modification also realigned program funds from the grants fund (component one) to components two and three in order to add more staff to what was agreed was an understaffed program. Program staff went from 13 to 18 professionals. As of this Modification, the total value of the Component One grants fund had been reduced from

$14.4 million to $11.9 million. Based on the limited data available at the time in terms of average value per grant, it was believed that the target of 60 grants was still feasible.

In March 2013 USAID/Sri Lanka requested BIZ+ to expand its staff numbers in order to expedite implementation. On 25 April 2013, USAID/Sri Lanka issued Modification No. 3 to the Cooperative Agreement which realigned some program funds from component one (grants) to components two and three to support increased staff. As of this Modification, the total value of the Component One grants fund had been reduced to $10,705,902. At this time, the BIZ+ COP and AOR began discussions about revising the target of total number of grants downward to about 40-45 grants - to account for the reduced component one funding line. It was agreed at the time that this revision would be taken into account during the annual PMP update in August 2013.

On 25 July 2013 the Mission unexpectedly and unilaterally informed BIZ+ that it was necessary to start implementing its investment grant program in four new Districts in the North Central Province. It was communicated that this was related to an agreement made between the Minister of Economic Development and USAID/Sri Lanka's Acting Mission Director, Todd Sorenson. At this time, it is important to note that USAID had not given any indication or signs to BIZ+ of the impending TEC reduction which was to be announced three weeks later. When the instruction to begin implementation in the North Central Province and, at which time the existing Component One's grants budget had already been allocated to 19 businesses with whom the program was developing partnerships and conducting due diligence, the program planned to absorb the additional grants needed within its existing budget of $24 million.

As of 1 August 2013, 1 year and 10 months into the project, BIZ+ had received 205 business applications. This is a positive indicator of the extensive awareness building and application review that had taken place during the project years 1 and 2. Twenty one grants had been approved and 19 approved grant applications were in the advances stages of due diligence and partnership development, which would have been submitted to USAID for approval by mid October 2013. This, combined with six new grants in the North Central Province, would have met the verbally agreed upon grants target of 40-45 grants which was under discussion and planned for in the yearly annual PMP update to be prepared in August 2013 and submitted to USAID by 1 September 2013.

On 16 August 2013, the COP was called in to USAID's office by the Director of Economic Growth, who verbally informed the COP that there was to be a significant TEC reduction, to reduce the total budget to somewhere between $16 to $17 million. At that time, the Director could not provide a firm figure. Because of this notification, and until a firm budget figure could be communicated, all partnership development and award of new grants came to a standstill.

On 11 September 2013, BIZ+ was formally informed of a new, reduced TEC amount of $17.6 million. Subsequent to this notification, the BIZ+ team was obliged to go through a difficult and tedious process to make decisions as to which, and how many, businesses could be funded within a significantly reduced budget. The process of choosing which of the 19 businesses with whom the program was in advanced stages of partnerships in development, was a lengthy process because it involved renegotiating, revising, and restarting the due diligence process for business plans of 19 businesses, who are often operating in remote sites, and then starting a fresh review process of each business plan to select only 8 of the 19 businesses.

During the period between 16 August to the end of October 2013, BIZ+ was obliged to go through a challenging process of (re) selecting grantees from both the 19 businesses who were on track to receive grants plus launch its program and reserve grant funds to support at least six additional grants in four new Districts in the North Central Province. During this period BIZ+ had to rethink its strategy on the best approach for the use of remaining funds, as well as review and negotiate new and revised business plans with 19 businesses in order to select only 8 of the 19 businesses in question, combined with launching a new awareness building effort in four new Districts. Therefore the selection of the additional 14 business, to meet a new target of 35 grants took significant time and effort.

Concerning the awareness building effort in the North Central Province, by this time, BIZ+ knew well that it was necessary to adopt an approach that would ensure all steps such as awareness building, seeking of applications, reviewing of applications, and conducting thorough due diligence for the expanded program areas within the period of time available. BIZ+ had extensive experience by that point in time to know that the process of awareness building to the award of grants, due diligence, environmental reviews, and the development of proper business plans took an average of about six months. At the writing of this report, BIZ+ has awarded six grants to businesses within the newly added province, within this six-month time period.

USAID/Sri Lanka would also like to comment on the section on inexperienced grantees (para 3 page 4). It is true that the amount of time to develop grants took much longer than anyone anticipated.
USAID/Sri Lanka concurs with the two primary reasons for this, as stated by the auditors including: 1) Weak capacity of business applicants, for the types of businesses the program targeted (small- to med-sized businesses in post conflict areas) combined with 2) Initial inadequate human resources in the program to support a grants program of the size and scale of BIZ+.

With respect to the capacity of business grantees, BIZ+ targeted small and medium size businesses, which were seeking to double or triple the size of their business. This was a big jump for these businesses. The capacity limitations of the business community in the targeted areas became a simple fact that BIZ+ had to adapt to during implementation. This limitation is common in small and growing businesses, which are often family-run, so it is not unique to Sri Lanka. However, the challenge is amplified in regions of Sri Lanka targeted by USAID because of the effects and isolation resulting from 30 years of civil conflict. For the one area that BIZ+ could control, however, USAID made the necessary adjustments during program implementation to increase program staff levels adding professional staff to advise and assist businesses and to provide additional due diligence prior to award of grants. BIZ+ started with 13 professional staff (+3 drivers). They are currently operating with 23 professional staff (+ 6 drivers). To help expedite due diligence, BIZ+ engaged several international financial industry professionals to assess business and financial plans.

It is also important to take into consideration that the targeted geographic areas, Northern and Eastern Sri Lanka, were largely cut off from the rest of the country for 20-25 years. Further, in many parts of these areas, the government was not operating at all, and laws and regulations were stipulated by the designated Foreign Terrorist Organization, Liberation Tigers of Tamil Eelam

(LTTE), who controlled the geographic areas for most of the 26 year civil conflict where BIZ+ is operating. As such, many of the business owners were not up to date, or in many cases, aware of several important regulatory requirements such as registration, annual audited accounts, and environmental licenses. It takes time for the business to obtain the necessary approvals and become compliant. BIZ+ felt it was critical that businesses it supports be 100% compliant with Government of Sri Lanka (GOSL) laws and regulations.

In addition, the size and scale of the business expansion activities are not micro-level and therefore it was important for the program to ensure that US government funds were invested responsibly. For BIZ+ investment grantees, the average expansion investment is valued at $635,000. With an average investment by USAID of $213,000 per grantee, the business owners were expected to come up with the remaining amounts. The context, in which BIZ+ is working, combined with large investment values, required time and effort on both BIZ+ and the grantee business's side to ensure that the business plan and financing were realistic and viable. It has been in the best interest of the USG to invest more time in due diligence and capacity building when it came to business planning, because strong business plans and capable businesses are more likely to succeed.

Although it took longer than expected, thorough due diligence performed by the BIZ+ team on prospective business applicants was in the interest of the USG and increases the chances that the program will meet its targets. During the RIG audit, BIZ+ shared documentation and anecdotes with the auditors about its thorough due diligence process. The auditors also had in-depth discussions with grantee business about the benefits of the business planning process alone.

USAID/Sri Lanka would like to comment on section on Procurement Delays (page 4).
The payment of value added tax (VAT) and Duty by Land O'Lakes during the implementation of BIZ+ is considered in most instances an unallowable cost by USAID. USAID/Sri Lanka would like to offer some additional information to the RIG in order to provide additional details and background on the extensive challenges encountered by BIZ+ to obtain VAT and Duty exemptions. BIZ+ did not receive full agreement and a formal exemption for payment of VAT from the Government of Sri Lanka (GOSL) until March 2013, 18 months into program implementation. And even then, the exemption only applies to local purchases. BIZ+ is making large purchases of industrial equipment outside of Sri Lanka and must negotiate VAT and Duty exemptions for imports on a shipment-by-shipment basis. Several of the relevant GOSL Ministries who were involved in approving the exemption initially were reluctant to provide VAT exemptions to support private sector companies.

As a result of persistent and repeated efforts by both BIZ+ and USAID to secure a VAT and Duty exemption from the GOSL since the start of the program, BIZ+ was successful in obtaining a six-month VAT exemption, only applicable for local purchases, on March 20, 2013, 18 months into the program. This made it impossible to make any large purchases as USAID would not allow BIZ+ to pay taxes, even on a temporary basis. The existing VAT exemption is valid for six months and must be renewed upon review of detailed purchasing and financial reports. Since BIZ+ started its program to award grants in the newly added province, dealings and cooperation by the GOSL has improved significantly.

Adhering to GOSL procedures, it took BIZ+ over four months to clear its first shipment from the port. At present, it still takes BIZ+ an average of 4-5 weeks to clear an import which leads to implementation delays by the grantee.

As stated above, the VAT exemption that was eventually obtained only covers local purchases. The GOSL does not provide blanket exemptions for VAT or Duty for purchases of equipment that is imported into the country. In order to get the necessary exemptions for VAT and Duty on imported purchases, of which BIZ+ has many (30+ shipments) BIZ+ is obliged to apply for exemptions on a case-by-case basis. In addition, VAT and Duty exemptions are applied for in two separate processes. Three separate Ministry approvals are required for each shipment.

In sum, the issue of VAT and Duty exemptions is an ongoing challenge. Often these challenges affect BIZ+ grantees' ability to meet their milestones on time. However, BIZ+ is working through the challenges and within the complex operative environment effectively, and despite the challenges, USAID is seeing significant progress made in purchasing, spending, and in grantee implementation.

USAID/Sri Lanka would like to make a factual clarification concerning the grants target. BIZ+ has two separate types and indicators for grants. It has investment grants (component one) and service grants (component two). The target for investment grants was initially set at 60, and 20 for service grants. As of 30 September 2013, BIZ+ had awarded a total of 29 grants, including 21 investment grants and 8 service grants. The report compares the 21 investment grants awarded to the combined target of 80 rather than 60, therefore it is misleading.

RIG RECOMMENDATION No. 2:
Require Land O'Lakes to adjust to realistic targets for the number of jobs to be created by all grantees.

USAID/SRI LANKA'S RESPONSE:
USAID/Sri Lanka concurs that it is a worthwhile initiative to re-examine the jobs target established per grantee.

Corrective Action No. 1:
USAID has instructed BIZ+ to evaluate the progress of each of its 36 grant investment activities in order to evaluate progress towards reaching the target against the established timelines outlined in their sub awards, as well as the time remaining in the overall BIZ+ program. If necessary, the evaluation would result in an adjustment to expected timing as well as a revision of the grantee business's jobs target. This exercise will be completed by 31 July 2014.

Clarifying information:
While USAID/Sri Lanka believes that the jobs target established under each business expansion activity is realistic and grounded in careful and thoroughly vetted business planning, the time horizon provided for in the BIZ+ program may not allow enough time to capture the results before the program's end. In this same vein, due to the reasons explained below, an evaluation of progress against time remaining would be a valuable exercise.

The table on page 6 of the report is based on the program description of the Cooperative Agreement (CA) with a TEC of $24 million. Modification 5 of the Cooperative Agreement which was completed on November 25, 2013 while the audit team was in country, revised the program description with revised targets. Based on the revised targets the table should be as follows:

Indicator	End-of-Program Target*	Target by Year 2	Achievements by Year 2	% Achieved
Number of jobs created	5,000	-	190	3.8
Increase in annual household income†	$4 million	-	$140,054	3.5

USAID realized that the CA specification of 144 jobs per $100,000 was highly unrealistic for the SME sector in Sri Lanka when program implementation commenced. According to this specification each job will require a grant of $694. The applications that BIZ+ received in response to its awareness programs and request for applications (RFA) confirmed that the USD investment cost per job is high. The average investment cost per job was found to be $4,486 which includes USAID grants per job of $1,522. Furthermore, some sectors will generate more jobs than others and BIZ+ is not a sector specific program. If BIZ+ had focused on a few labor intensive sectors, it would create a marketing problem for the several assisted enterprises as USAID has directed BIZ+ to only assist companies catering to the domestic markets and not for the export market.

Appendix III of the RIG report is misleading and should include a column which indicates time elapsed since grant awarded. An analysis of the table shows that out of the 21 grantees, 4 grants were awarded in September 2013. There are 13 grantees out of 21 who had been awarded less than six months earlier. Of the 21 grantees, 20 grantees have been awarded less than 12 months earlier. It is impractical to expect an enterprise to create jobs overnight. Sufficient time is required for investment activities to be completed before hiring employees.

Before explaining the proposed specific corrective action to be taken, it is important to explain in more depth two important considerations that are central to achievement of program results, namely jobs. Due to the number of grant activities to be reviewed, and time allocated to study and review the detailed information supporting each grant negotiation, there may not have been sufficient time for the auditors to examine to this level of detail.

There are two points which the Mission feels may be helpful to explain further, including:

a) A detailed explanation of how jobs targets were established for each grantee, providing examples of the careful analysis that has taken place to establish the targets in the first place. It is also important to note that USAID has carefully reviewed and approved jobs targets proposed in each sub award when each sub award was proposed for approval.
b) The time horizon allowed to realistically monitor and to capture results in a normal business environment.

Process of establishing jobs targets for each grantee:
BIZ+ thoroughly evaluated the potential employment creation and income earning opportunities for each grantee during the due diligence process. The expectations and core evaluative criterion around jobs was communicated to potential business during the community outreach phase and

incorporated into program brochures. The presentation of a *jobs table* (desegregating employment creation by category of job and gender and ethnicity of employee) is required in the standardized format for a concept note and is then further detailed in the business plan. If a business proposed a jobs target at the Concept Note stage that appeared unreasonable or unattainable in the period of the grant, the concept note was rejected.

At the initial evaluation stage, for the majority of concept notes reviewed, the business applicants were requested by BIZ+ to provide detailed justification of their proposed jobs tables as a condition of being invited to submit a full application and business plan. Moreover, businesses were instructed to budget for all salaries and labor costs when making their five-year financial projections for the business expansion. The financial projections and business plan then formed the basis for BIZ+'s due diligence review and further analytical testing as to whether or not the businesses plan was viable. Additionally, wherever possible, the employment creation potential was also compared to industry standards. For example, in the hotel industry, projected jobs can be compared to a multiple of rooms offered based on the quality rating of the hotel property. In agriculture, the supply network and nature of the direct contractual relationship and the provision of services or inputs from the processing or manufacturing business was mapped. And in another case that includes an apprenticeship program, the cycle of on-the-job trainees was evaluated.

The example[4] selected by the auditors – a company manufacturing biomass briquettes - is actually a good example to illustrate the reasonableness/ "right-sizing" approach that BIZ+ employs to determine jobs targets:

- In the original concept note, this company estimated that 102 full-time positions and 400 supply chain jobs could be created in the first year of operations of the new biomass briquette factory (and generating additional 500 supply jobs in the second year). When the concept note was approved, BIZ+ instructed the business to examine the community out-grower scheme and attest to the job creation potential.
- In the full application, which contains a business plan and financial projections, the company estimated 108 fulltime workers (8 in administration and 100 in the factory) and 1000 indirect jobs in collection and supply. The out-grower aspect was removed because it was deemed that there would not be sufficient time in the partnership to implement this part of the plan. However, it should be noted that the company's owner will still move forward with this part eventually.
- During its thorough due diligence process, BIZ+ reviewed the job numbers and labor costing. After the analysis and in collaboration with the business, the number of fulltime jobs was reduced to 72 and number of supply and collection jobs targeted at only 100. BIZ+ also determined that compensation rates were too low and conducted sensitivity analysis on the financial projections. After adjusting financial assumptions for higher compensation rates in cost of sales and administration, the adjusted net profit after taxes dropped by nearly 56 percent and the revised forecasted profit margin was two percent lower than the company's 2013 profit margin. After making financial adjustments, BIZ+ determined that

[4] BIZ+ provided the RIG audit team a complete set of documents outlining the history for the subject partnership development, including, concept note; concept note evaluations; approval of concept note and request to prepare application; full application, business plan, and financial projection; and due diligence report.

the business plan conservatively reflected a realistic margin for Year 1 production and that employment could be attained. Again, BIZ+ specifically analyzed what could be accomplished within the time horizon of the partnerships. The following is quoted from the due diligence report that was conducted by an experienced investment banker on a volunteer assignment:

"The Company expects to directly employ 72 workers for the factory. In addition it will have a very large knock-on effect with the local community, as hundreds of people will be able to gather local biomass waste and sell it to the company. We have verified the employment rosters at both the Horana and Moratuwa factories. It seems quite reasonable that the projected employment numbers will be attained. The Company currently anticipates running 2 shifts daily. There could be the possibility of adding a third shift requiring an additional 20 factory workers.

Based on review of the employment roster BIZ+ would expect that factory workers are paid a monthly total of LKR16,000 in Gross Wages versus the company plan of LKR15,000. Drivers are paid LKR35,000 versus business application of LKR20,000, and Plant Manager in line with the business application assumption of LKR50,000. Our financial assumptions above should capture such costs as they are imbedded in our higher Cost of Goods Sold ratio used to calculate Net Profits."

The jobs table, as well as the due diligence report, for the company is included in Appendix-D. In this document it is possible to review in detail the approach taken above for this company. The auditors' comparison to the current operations is a logical starting point, but they did not take into account other important information including the differences between the existing operation and the new operation. Therefore, the Mission counters the conclusion that the jobs target for the company is unrealistic, for the following reasons:

1. The new plant at the new location in the Eastern Province will operate in two shifts with 20 workers average per shift and thus a total of 40 factory workers. The number of workers per-shift is actually less than the average number of factory workers working at the two existing plants near Colombo. As noted by the auditors those two plants have 48 factory workers operating on a single shift, thus employing on average 24 factory workers per shift per plant.
2. The new plant will employ 18 collector positions that are unique to the new operation. The existing operation does not have these positions.
3. The expansion to a third factory will be situated in a new location that is geographically remote from the owners' and directors' oversight. Accordingly, the company will need additional accounting and administration professionals in order to manage the business and have adequate financial and other internal controls. BIZ+ sub award agreement stipulates that the company to employ certified accounting staff. These positions are not in place in the current operation because management uses the services of the professional staff from a related business.
4. Staffing for plant manager, drivers, and security personnel (7 positions in the new plant) are comparable for the three plants.

Time horizon for the BIZ+ Program:
Job creation was fundamental in USAID's design of the BIZ+ program. In the Sri Lankan context, by providing financial investment support to small and medium private businesses, the business will expand more rapidly than it otherwise would. As a result of the investment, the expanded business will hire more employees and buy more inputs from suppliers; the extra income created for employees and suppliers will be used to buy goods and services in the community thereby increasing income for other businesses and creating an economic churn that has widespread positive impact in communities. From an economic development perspective, the Mission maintains that the logical framework for the program is valid and that business, job, and economic growth will result. Further, not only will business investment result in economic growth in the target regions, the approach employed by BIZ+ to thoroughly vet each business plan, combined with the requirement to share the risk of the investment on a 1:1 basis (although the program will exceed this ratio by 2:1, Grantee Investment: USAID Investment) the growth resulting from BIZ+ investments is 100% sustainable and highly likely to continue. There is, however, an inherent challenge to be able to capture all economic development results within the period of performance of the BIZ+ program, which ends on 30 June 2015. This time challenge has been further magnified due to the shortening of the program by three months, which was necessary due to USAID's significant TEC reduction. Even the original full 48-month period of performance was ambitious to be able to capture all economic growth impact.

The Mission is confident that the expected impact on jobs and increased income, as implemented across all regions in targeted regions are realistic. The indicators of positive economic impact are being seen already, as BIZ+ supported-businesses clearly show how their growth is supporting the creation of jobs, and perhaps more importantly, providing income earning opportunities to other businesses along the value chains in which they work. Additionally, in many BIZ+ supported businesses, they are producing products at a lower cost, therefore, also benefiting consumers. Internationally accepted economic growth measurements dictate that a 45-month implementation period may not be sufficient to measure and capture all results and impact of a program like BIZ+. Currently, BIZ+ is supporting 36 investment grants which are on track to yield over 5,000 jobs. In addition, conservatively applying an accepted multiplier tool developed by the International Finance Corporation, BIZ+ support to businesses will create an additional 6,000 indirect jobs along the business value chains. That is a total of over 10,000 jobs. However, the main constraint to reporting these results is based on a limited timeframe to implement and monitor results of business growth and resulting economic impact.

BIZ+ was designed by USAID to provide grants to businesses ranging from $50,000 - $500,000. Within the Sri Lankan context, which is not dissimilar to business growth in both developed and developing countries, this level of investment and growth is significant. It is also important to note that BIZ+ is not supporting micro-businesses whose business activities are limited in scale and sophistication, and for whom expansion is a simple influx of money. Rather, BIZ+ is supporting small and medium size businesses, which are often increasing their number of employees and production levels 3-5 fold. These same businesses are adopting new technology, improved management practices, and finding new markets (although a clear market strategy is reviewed during the due diligence process). The simple fact is that these type of businesses do not grow overnight, and even within a couple of months. Nowhere in the world would USAID see results from business growth within such a short time. Thus, BIZ+ supported businesses, which are undertaking significant expansion activities, need sufficient time to complete the investment activities, absorb new capacity and skills they are gaining, as well as train new staff to meet increased production levels and needs. Thus, it is important to assess whether or not the timeline provided for the program is commensurate with worldwide standard outcomes for growth of small businesses. Therefore, mission concurs that it may be necessary to re-examine what results can be captured and achieved within the 45 month period of Modification No 5 dated November 25, 2013.

RECOMMENDATION No. 3:
Direct Land O'Lakes to perform an evaluation of all grants covering the remainder of the Biz Plus Program, look at accomplishments and analyze the reasonableness and validity of the business idea in the grant proposals to confirm that the grants comply with the program objective.

USAID/SRI LANKA'S RESPONSE:
USAID/Sri Lanka concurs with the auditor's recommendation.

Corrective Action:
The auditor's recommend that USAID direct BIZ+ to, "*to perform an evaluation of all grants covering the remainder of the Biz Plus Program, look at accomplishments and analyze the reasonableness and validity of the business idea in the grant proposals to confirm that the grants comply with the program objective*." The mission believes that the corrective actions implemented under recommendations No. 1 and 2 satisfactorily address this recommendation.

Clarifying Information:
BIZ+ has thoroughly reviewed, vetted, and conducted due diligence to confirm the reasonableness and the validity of each grantee's business idea to confirm that the grants comply with the program objective. The mission is satisfied with the process that BIZ+ adopts to evaluate proposals. All BIZ+ sub grants are subject to approval by USAID before award. At the submission of the request for prior budget approval of each sub award, USAID has also reviewed and considered the validity and reasonableness of each business idea before providing its approval.

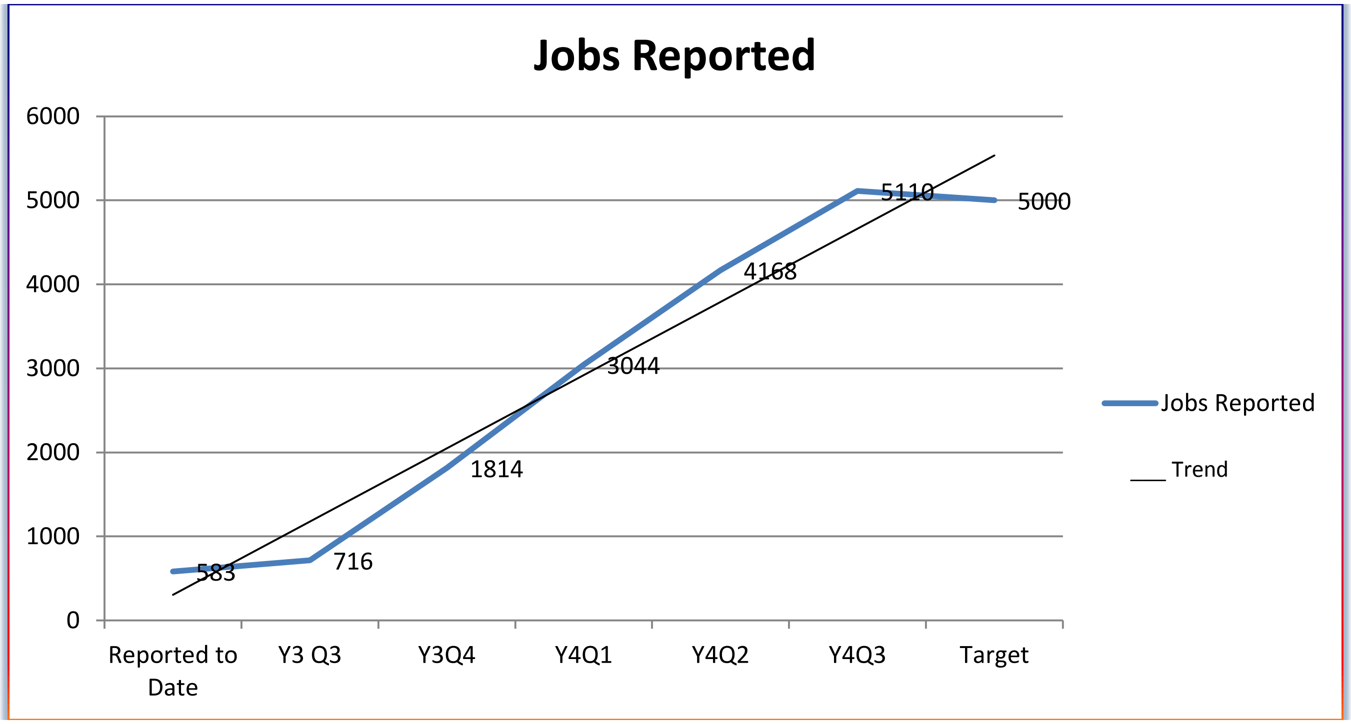
RECOMMENDATION No. 4:
Conduct a cost-benefit analysis to determine if the program should continue.

USAID/SRI LANKA'S RESPONSE:
USAID/Sri Lanka does not agree that a cost-benefit analysis of the BIZ+ program is necessary.

Corrective Action:
Mission recommends that no corrective action is needed for this recommendation.

Clarifying information:
The program has already met or exceeded several of its indicator targets, and has demonstrated to USAID that it is on track to meet its projected program results. As explained above, while there is some risk of capturing all program results within the time remaining, the Mission is confident that BIZ+ will achieve significant results by the end of the program, including the creation of 5,000 jobs

plus more than 6,000 indirect jobs. While significant results have not been reported in the first two years of the program, especially in terms of jobs and household incomes, the Mission can already see a steady increase in numbers during the first two quarters of Year 3, for all indicators, including new jobs and increased household income. This trend will continue throughout the remaining time of the program. The graph below which projects the reporting of jobs in the remaining quarters further supports this conclusion. The data from this report is compiled using actual jobs targets within existing sub awards, and plotted against the remaining time period of the program.



As of the writing of this report, BIZ+ has solid data to show increased income to over 1000 individuals[*] in targeted regions as a result of BIZ+ investments. Despite several challenges encountered in the early years of the program, the program has maximized use of program funds and is fulfilling its objectives in both components one and two.

There are also five other important factors to consider as to why a cost benefit analysis would not be a good use of time and money. These factors are enumerated below:

1. A cost benefit analysis could pose a significant risk to the relationships between grantees, United States Government (USG), and GOSL. As it enters its last 14 months, BIZ+ has signed investment partnerships (grants) with 36 businesses, exceeding the targeted 35 businesses which were established in Modification No.5. It should also be noted that in Modification No. 5, while the grants fund (component one) is valued at 45% of the original budget line of $14.4, the BIZ+ team has provided grants to 36 companies, which is 60% of the original target. The value of funds fully obligated to these 36 grant activities at present exceeds $7.6 million.

2. Perhaps more important is the fact that BIZ+ grantee business owners have secured and spent significant amounts of their own funds to construct buildings, to order raw materials, and to hire people based on the explicit agreement and expectation that USAID will fulfill its commitment inherent by USAID's Agreement Officer's approval of the BIZ+ sub award. All selected businesses have made real and firm financial commitments as part of their contribution. The key word here is partnership. Before a grant is awarded, the financial commitments made by each party are based on a firm business plan in which the shared financing is implicit. Very often, bank loans obtained by grantee businesses are contingent on BIZ+ support.

3. To date, grantee businesses have committed over $15.1 million in financial contributions, and have reported over $4.2 million in real expenditures. Reporting of expenditures is often consolidated and reported once an expansion activity is completed, so in actuality, the real value of grantee expenditures to date ranges from $10-12 million. Further, during the experience of last August – October 2013, when BIZ+ was obliged to cancel several partnerships in development due to the TEC reduction, experience has indicated that grantee mobilization and expenditure of funds happens well before the signature of the grant. Thus, at this point in time, the value of funds that all BIZ+ grantees have expended is significant. Any compromise or reduction of BIZ+'s financial commitment would cause serious hardship to these businesses, and could even lead them to bankruptcy.

4. In these partnerships, as part of its commitment to implement each grant according to established timelines within the sub award agreements, BIZ+ has already invested a significant amount of USG funds – approximately $4 million – to place orders of equipment and machinery with local and international suppliers. International orders are tied to irrevocable letters of credit, while all Purchase Orders, local or international, would not be cancellable per their terms and conditions. BIZ+ is also supporting the implementation of eight construction projects, whose contract terms would not support cancellation, and would leave the grantee

*This figure includes both full time and part-time jobs.

businesses vulnerable to pay out the contract without BIZ+ support. Thus, the value of money invested by both partners – BIZ+ and the grantee business – is significant and non-reversible. All money invested is leading businesses towards completion of their expansion activities and to increased jobs and income. Any alteration to financial commitments to grantees by BIZ+ is very likely to cause a number of insurmountable legal challenges to Land O'Lakes, VEGA, and USAID.

5. Finally, while the Mission firmly believes the benefit to the USG of the BIZ+ program is already evident, by the results reported thus far, and the regular progress shown, any threat to further reduce or shorten the time frame of the program would likely have serious political ramifications for the USG with the GOSL. The Ministry of Economic Development (MED), the "host" Ministry, views BIZ+ as a very good and successful program and is completely satisfied with its progress. BIZ+ and USAID have worked very hard to win the

confidence of MED. It is also likely that BIZ+'s positive progress has helped USAID/Sri Lanka with negotiations to start other programs.

RECOMMENDATION No. 5:
Require Land O'Lakes to design and implement a plan to comply with the leveraging contribution requirement of the agreement.

USAID/SRI LANKA'S RESPONSE:
USAID/Sri Lanka concur with the recommendation and the corrective action has been implemented.

Corrective Action:
VEGA submitted a modification request on May 19, 2014 to USAID that included a section to clearly define what should be reported as cost share and leverage. Modification No. 7 adjusts and defines cost share and leverage.

RECOMMENDATION No. 6:
Require Land O'Lakes to review and correct the reported cost-share and leveraged resources to confirm the reported amounts comply with the program agreement requirements.

USAID/SRI LANKA'S RESPONSE:
USAID/Sri Lanka concur with the recommendation and corrective action has been implemented.

Corrective Action:
Modification No. 7 adjusts and defines cost share and leverage. BIZ+ has changed its reporting procedures to comply with revised and clarified definitions for cost share and leverage in the cooperative agreement.

Clarifying Information:
Although BIZ+ had reported $2,509,645 in non-USG resources supporting program objectives at the end of Year 2, there was lack of clarity and inconsistency between the language in the Performance Monitoring Plan, the Cooperative Agreement, concerning what should be reported as cost share and what should be reported as leverage. In fact, all non-USG resources reported to date qualified as cost share per ADS 303.3.10.2. Before the auditors arrived in country, the BIZ+ COP was in discussions with the USAID AOR on how to approach this challenge and had developed a white paper to present the problem. The AOR used the white paper to seek the guidance of the AO on the matter.

On February 26, 2014, BIZ+ and USAID/Sri Lanka officials, including the AO, the Controller, the AOR, and the Director of Economic Growth, held a meeting to discuss cost share, match and leverage as noted in the program description, the Performance Monitoring Plan, and the approved budget. At that meeting, it was agreed between all parties that there was also a need to streamline the use of the terms cost share and match. Further, it was agreed that it was necessary to more clearly define the types of costs that would be reported as cost share vs. leverage, because the types of costs that BIZ+ was capturing qualified as cost share per ADS 303.3.10.2. In order to clarify these definitions it was also agreed by all parties that a modification to the CA was necessary to not only clarify and streamline Agreement language, but also revise the budget to clearly delineate what would be considered cost share vs. leverage. BIZ+ submitted a modification request to USAID. A copy of this request is found in Appendix E. A copy of Modification No.7 is given in Appendix F.

List of Attachments:

1. Appendix A-Approved VEGA Biz + Performance Management Plan Year 3 Revision Final
2. Appendix B-Achievement Tool and Site Visit Report
3. Appendix C-Example of Biz + Weekly Update
4. Appendix 1-Job Data Reported and Projected by Grantee for RIG Management Response
5. Appendix 2-Income and People benefitted data
6. 2014, 08 04, Action Memo from MD to RIG
7. Signed Memo – Management's Comments
8. Additional Information Final

Jobs Created and Income Generated by Grantees as of September 30, 2013 (audited)

#	Type of Business and Location	Grant Amount ($)	Jobs to be Created	Jobs Created by Year 2	% of Jobs Created	Remaining Time on Project (months)	Income Generated by Year 2 ($)
1	Coconut Fiber Manufacturing Plant, Ampara, District	108,185	101	3	3	21	67.18
2	Tourism and Retail Business, Trincomalee District	142,032	143	31	21	16	27,467.21
3	Agriculture Tools & Machinery, Ampara District	396,167	162	2	1	16	25,914.51
4	Building Material Plant, Ampara, District	259,842	125	-	-	21	2,235.07
5	Biomass Briquettes Factory, Batticaloa District	224,577	72	-	-	19	-
6	Agricultural Production Plant, Batticaloa District	497,201	150	4	3	21	3,740.08
7	Tire Re-treading Plant, Ampara District	312,982	213	28	15	12	14,514.14
8	Hotel Facility Expansion, Jafna District	451,220	116	4	3	20	-
9	Ice Production Plant, Jafna District*	253,351	80	37	46	3	14,501.53
10	Ice Production Plant, Trincomalee District	246,106	60	8	13	21	1,692.70
11	Garment Factory, Kilinochchi District	179,356	113	-	0	20	-
12	Garment Factory, Vavuniya District	177,167	47	12	20	17	5,430.84
13	Construction Company, Jaffna District	103,321	55	18	32	15	2,786.18
14	Hotel Expansion, Vavuniya District	255,567	150	-	-	19	-
15	Footwear Factory, Batticaloa District	279,677	63	16	25	12	17,950.96
16	Food Processing, Vavuniya District	246,797	53	-	-	21	-
17	Hotel Expansion, Trincomalee District	485,883	138	2	1	21	15,093.28
18	Construction Company, Jaffna District	383,791	101	25	25	21	8,660.04

#	Type of Business and Location	Grant Amount ($)	Jobs to be Created	Jobs Created by Year 2	% of Jobs Created	Remaining Time on Project (months)	Income Generated by Year 2 ($)
19	Auto Repairs, Batticaloa District	211,593	85	-	-	19	-
20	Poultry Farm, Vavuniya District	255,031	96	-	-	20	-
21	Bakery, Vavuniya District	199,638	81	-	-	19	-
	Totals	**5,669,484**	**2,204**†	**190**			**140,053.72**‡

* This grantee is already operating at full capacity, as discussed on page 6.

† Total number of jobs per grant agreement (verified).

‡ Figures reported in Sri Lankan local currency and converted to U.S. dollars at the rate of 130 LKR = $1.00.

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