



# OFFICE OF INSPECTOR GENERAL

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## AUDIT OF USAID'S LEBANON INDUSTRY VALUE CHAIN DEVELOPMENT PROJECT

AUDIT REPORT NO. 8-268-14-001-P  
JULY 8, 2014

RIG/Frankfurt



*Office of Inspector General*

July 8, 2014

**MEMORANDUM**

**TO:** USAID/Lebanon Mission Director, Azza El-Abd

**FROM:** Acting Regional Inspector General/Frankfurt, David Thomanek /s/

**SUBJECT:** Audit of USAID's Lebanon Industry Value Chain Development Project (Report No. 8-268-14-001-P)

This memorandum transmits our final report on the subject audit. We have considered your comments on the draft report and have included your responses, without attachments, in Appendix II.

The report contains three recommendations to help USAID/Lebanon improve its Lebanon Industry Value Chain Development Project. In its comments on the draft report, the mission agreed with all three recommendations. Having evaluated management comments, we acknowledge the mission's management decisions on all three and final action on Recommendations 2 and 3. Please coordinate final action on Recommendation 1 with the Audit Performance and Compliance Division in the Office of the Chief Financial Officer.

Thank you for the cooperation and courtesy extended to the audit team during this audit.

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# SUMMARY OF RESULTS

Despite Lebanon's relatively small size, USAID/Lebanon believes the Middle Eastern nation has many characteristics, such as geographic access to European markets, ability to produce early-season fruits and vegetables, and a liberal business environment that should give it certain competitive advantages in some markets. Nevertheless, officials at the mission believe that many Lebanese products and services are less competitive than they could be, primarily because 15 years of civil war have damaged infrastructure and depressed investment.

The mission awarded a 5-year, \$41 million contract to Development Alternatives Inc. (DAI) to implement the Lebanon Industry Value Chain Development Project. It started on September 30, 2012, and ends on September 30, 2017. The goal was to unlock more of Lebanon's economic potential and increase incomes in rural areas by making targeted small and medium-sized businesses more competitive. The contract defines a value chain as "a string of companies working together to satisfy market demand." After an initial assessment, the project selected eight value chains: olive oil, rural tourism (which includes handicrafts), floriculture, grapes, pome and stone fruits,<sup>1</sup> "rural basket products" (such as eggs and honey), and processed foods. Through December 2013, the project obligated \$16.8 million and spent \$5.1 million.

The Regional Inspector General (RIG)/Frankfurt conducted this audit as part of RIG/Cairo's fiscal year (FY) 2014 audit plan to determine whether USAID/Lebanon's Industry Value Chain Development Project is developing competitive value chains to increase income for rural populations.

The audit found that, the project generally was making progress toward targets but lacked a definition for a "fully functioning value chain" (page 4) that would enable the mission to evaluate the impact of this project objective. In addition, security restrictions prevented the audit team from conducting sufficient site visits to assess all project grants implemented as of March 2014.

The project had some accomplishments:

- In March and April 2013, DAI completed value chain assessments that mapped out opportunities and strategies for the value chains under consideration. In May 2013, DAI selected eight for the project. Afterward, activities designed to strengthen the value chain began in earnest. As of March 5, 2014, DAI assisted more than 600 farmers through 16 grants, primarily in villages hosting Syrian refugees.
- DAI awarded two grants that showed potential and demonstrated elements of sustainability. One supported the creation of cross-country skiing, snowshoeing, and hiking attractions, and the other provided mechanical olive harvesters to cooperatives.

The first activity provided skis, boots, snowshoes, and USAID-branded jackets (shown on the next page) for trail guides. The grant helped the beneficiary establish trails and signs (shown on the next page) and train the guides. The beneficiary had a clear business plan for earning revenue and reinvesting in ongoing training and equipment maintenance. The grantee cited requests from professional guides to book snow activities as evidence of

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<sup>1</sup> Pomes are fleshy fruits like pears and apples that have seeds at the core.

market demand. Unfortunately, during the winter of 2013 and 2014 Lebanon received its lowest amount of snow in decades, which hurt business.



To help Lebanon’s tourism sector develop snowshoe and cross-country trails in rural areas, USAID provided ticket booths, signs (right), and jackets for tour guides (left). (Photos by RIG/Cairo, March 11, 2014)

The second grant provided mechanical olive harvesters (pictured below) to six cooperatives that they then could rent to farmers. By renting this equipment from the cooperatives, farmers were able to improve productivity while lowering their costs.



Olive harvesters like these helped farmers in the villages of Ibrin and Douma boost their productivity. (Photos by OIG, March 6, 2014)

Nevertheless, the audit found project shortcomings listed below.

- One expected result was not defined (page 4). The contract identifies “seven fully functioning value chains” as an expected result. However, neither the mission nor DAI defined what makes a value chain fully functioning.
- The project did not conduct full grant sustainability analyses in all cases (page 5). There is no demonstrable demand for the products one grant facilitated.

In response to these audit findings, we recommend that USAID/Lebanon:

1. Collaborate with DAI to define “fully functioning value chains” in writing, and create an associated indicator in the monitoring and evaluation plan (page 4).
2. Document a sustainability assessment of handicraft activities before continuing with additional grants in the value chain (page 5).
3. Implement procedures to confirm that grant sustainability analyses (as required by the project’s grant manual) are complete and address both financial and operational sustainability (page 5).

Detailed findings appear in the following section. Appendix I contains information on the scope and methodology. Management comments, without attachments, are included in Appendix II. Our evaluation of management comments is on page 6.

# AUDIT FINDINGS

## Expected Result Was Not Defined

According to the contract, developing “fully functioning value chains” is an essential purpose of the project. The contract states, “The project aims to increase the competitiveness of selected value chains.” In addition, the contractual list of expected results includes “a minimum of seven fully functioning, competitive value chains.”

However, the contract did not define what a fully functioning value chain was. Neither the mission nor DAI could define the phrase either. This was not done because (1) the monitoring and evaluation (M&E) plan did not include an indicator directly measuring it, (2) the intent of the phrase was not resolved during project design, and (3) USAID/Lebanon’s country development coordination strategy (CDCS), which helps define and align project goals with mission goals, was in process when the project was being designed.

While the M&E plan included indicators such as *Value of exports of targeted agricultural commodities as a result of [U.S. Government] assistance* that could measure progress toward a more competitive or better functioning value chain, there was no indicator directly counting the number of fully functioning value chains. In general, M&E plans should include indicators for all expected results. For this project, the approved M&E plan appropriately included detailed definitions for each indicator such that had the M&E plan included the development of an indicator counting fully functioning value chains, an operational definition would have been defined.

Furthermore, the intent of the phrase was not clarified during project design. The contracting officer’s representative (COR) did not know why the phrase was not defined but suggested that it was not defined because it was intended to indicate that other expected results were to be achieved by working in seven value chains. Furthermore, DAI also could not explain why there was no definition for a fully functioning value chain. Nevertheless, the contract lists seven fully functioning value chains as an expected result.

Finally, the CDCS was in process when this project was designed. Had the CDCS been completed the project goals would have aligned with the CDCS and that could have helped clarify the definition of a “fully functioning value chain” in this case.

Defining fully functioning value chains is important for making management decisions and evaluating results. Without a definition, the mission does not know when to stop spending money in one value chain and divert resources to another. Likewise, the mission cannot know whether the project has achieved its purpose and will not be able to use it when evaluating the efficiency of various measures when designing future projects.

**Recommendation 1.** *We recommend that USAID/Lebanon collaborate with Development Alternatives Inc. to define a “fully functioning value chain” in writing, and create an associated indicator in the monitoring and evaluation plan.*

## **Project Did Not Conduct Full Grant Sustainability Analyses in All Cases**

USAID's Automated Directive System 201.3.15.3 defines outcomes as sustainable when they are able to "continue or evolve under their own momentum or actions, without continued donor intervention" and requires that sustainability be incorporated into project design from the beginning. Sustainability considerations include recurring costs and future income (collectively referred to below as financial analysis) and local institutional capacity.

In addition, the grant manual developed for this project identified sustainability, both financial and operational, as selection criteria for grants under contract. USAID's project design sustainability analysis tool also considers whether there is demonstrable demand for an activity or service.

Of 16 active grants for the value chain project, only one had a sustainability analysis that considered both financial analysis and institutional capacity. Four considered only the financial analysis. For most grants, the analysis was simplistic and incomplete. For example, one financial analysis reads, "Income generation and creating jobs for women who will ideally continue providing handicrafts to identified buyers and participate in future fairs."

The COR said that, given the quantity of grants, a full sustainability analysis of each one might overwhelm the project, particularly because the mission had already conducted a cost-benefit analysis for them. While the cost-benefit analysis fulfills the financial component of the sustainability analysis, it ignores the institutional capacity component. Furthermore, as noted above, in most cases the documented sustainability analysis consisted of only a couple of sentences.

As a result, some grant activities may not be sustainable. For example, one grant under the rural tourism value chain—specifically a handicrafts activity—provided kits and training to women in rural areas to make simple bracelets, charms, and decorative soaps. However, the women reported few sales, and the training did not cover sales or marketing techniques. The project did not demonstrate demand for the activity. The beneficiaries asked for more supplies to make more products despite reporting that most of their products remained in their homes as inventory. DAI officials said follow-up training would focus on creating distinctive designs (but not sales or marketing) to generate demand. DAI spent \$53,000 on this activity with follow-on activities planned. This could result in additional money spent on an unsustainable endeavor.

Therefore, we make the following recommendations.

***Recommendation 2.*** We recommend that USAID/Lebanon document a sustainability analysis and determine the sustainability of handicraft activities before allocating additional funds to the handicraft value chain.

***Recommendation 3.*** We recommend that USAID/Lebanon implement procedures to confirm that grant sustainability analyses (as required by the project's grant manual) are complete and address both financial and operational sustainability.

# EVALUATION OF MANAGEMENT COMMENTS

In its comments on the draft report, USAID/Lebanon concurred with all three recommendations. Having evaluated the comments, we acknowledge management decisions on all three and final action on Recommendations 2 and 3. A detailed evaluation of management comments follows.

**Recommendation 1.** USAID/Lebanon's COR and DAI agreed on a clear, measureable definition of a "functioning value chain." Accordingly, DAI's contract will be modified to replace "fully functioning value chain" by "functioning value chain" and include the definition of a functioning value chain. The target date for completing the contract modification is August 28, 2014. Accordingly, we acknowledge the mission's management decision.

**Recommendation 2.** USAID/Lebanon received a sustainability analysis of the handicraft project that DAI conducted and recommended a follow-up project that created marketing links for the handicraft products and providing training on business management to the recipients. Based on the mission's comments and supporting documentation, we acknowledge the mission's management decision and final action on Recommendation 2.

**Recommendation 3.** USAID/Lebanon's COR received and accepted the outline of the sustainability analysis that will be done for each grant under the DAI contract. This outline includes financial and operational sustainability analysis. Based on the mission's comments and supporting documentation, we acknowledge the mission's management decision and final action on Recommendation 3.

# SCOPE AND METHODOLOGY

## Scope

We conducted this audit in accordance with generally accepted government auditing standards. They 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's Lebanon Industry Value Chain Development Project is developing competitive value chains to increase income for rural populations. The \$41.7 million contract was awarded to DAI. The project obligated \$16.8 million and spent \$5.1 million through December 2013.

The audit covered the project from its inception on September 30, 2012, through March 1, 2014. In planning and performing the audit, we assessed the following significant internal controls: COR files, site visit reports, and administrative approvals for invoices. We reviewed contract deliverables reported complete. We assessed the adequacy of indicators, baselines, and targets of the M&E, and inspected supporting evidence for reported results. The scope was limited by security constraints. Because the Regional Security Office did not approve visits to all 16 grantees, we visited only 4. We conducted audit fieldwork from March 3, 2014, to March 18, 2014, at USAID/Lebanon and DAI in Beirut.

## Methodology

To answer the audit objective, we met with personnel from USAID/Lebanon, DAI, and beneficiaries. We reviewed documentation provided by USAID/Lebanon and DAI, including the M&E plan, activity approval document, the contract and modifications, and quarterly reports.

To assess progress toward project goals, the audit team interviewed DAI employees to understand reporting, measurement methods, and definitions, and we inspected supporting documentation for all 14 project indicators as of December 31, 2013. We inspected support for all reported results. To corroborate them, we requested site visits to all 16 grantees but the Regional Security Office approved only 4. The default materiality threshold for review of reported results was 10 percent; if errors in reported results exceeded 10 percent, we considered that material.

The audit team conducted site visits to four cooperatives (under one grantee) benefiting from one grant that provided mechanical olive harvesters, an olive oil exporter and grant beneficiary. Additionally, we visited two rural tourism grantees and individual and organizational handicraft beneficiaries (under another grantee). During site visits, we interviewed beneficiaries to understand whether the project met their expectations and achieved intended results. Testing of internal controls included review of COR files such as site visits, invoices, and contract deliverables.

# MANAGEMENT COMMENTS



June 30, 2014

## MEMORANDUM

To: A/Regional Inspector General/Cairo, David Thomanek

From: USAID/Lebanon Mission Director, Azza El-Abd/s/

Subject: Audit of USAID's Lebanon's Industry Value Chain Development Project (Report No. 6-268-14-00X-P)

USAID/Lebanon is in general agreement with RIG's recommendations. The Mission has taken corrective measures and implemented final actions for two Recommendations; Nos. 2 and 3, thus, we are requesting closure upon final report issuance.

**Recommendation No. 1:** We recommend that USAID/Lebanon collaborate with Development Alternatives Incorporated to define a "fully functioning value chain" in writing and create an associated indicator in the monitoring and evaluation plan.

**Mission Response:** On June 26, 2014 the Contracting Officer Representative (COR) in collaboration with the implementing partner Development Alternative Incorporated (DAI) agreed on a clear and measurable definition of a "functioning value chain" as follows:

A functional value chain is a competitive and inclusive value chain. Whereby, competitiveness can be measured by increase in sales, improvement in quality and productivity; and inclusiveness can be measured by the number of value chain participants including micro, small and medium enterprises (MSMEs), farmers and other organizations receiving assistance. The assistance can include business development services, application of improved technologies or management practices and facilitation of business linkages (Attachment A). The current monitoring and evaluation plan of Lebanon's Industry Value Chain Development (LIVCD) Activity includes indicators that measure competitiveness and inclusiveness of value chains. These indicators are:

- Value of incremental sales (collected at farm-level for small holders and firm-level for MSMEs) attributed to FtF implementation
- Gross margin per hectare, animal or cage of selected product
- Number of individuals who have received USG- supported short-term agricultural sector productivity or food security training

- Number of farmers and others who have applied improved technologies or management practices as a result of USG assistance
- Number of MSMEs, including farmers, and other organizations receiving business development services from USG assisted sources
- Number of MSMEs, including farmers, benefiting from new horizontal & vertical linkages

Accordingly, DAI contract no. AID-268-C-12-00001 will be modified to replace “fully functioning value chain” by “functioning value chain” and include the definition of a functioning value chain.

Target date for completion: August 28, 2014. A GLAAS requisition will be submitted by the COR to OAA to include the modification required along with the incremental funding action.

**Therefore, the mission believes that a management decision has been made. Evidence of final action will be submitted to M/CFO/APC for their consideration and closure.**

**Recommendation No. 2:** We recommend that USAID/Lebanon document a sustainability analysis and determine the sustainability of handicraft activities before allocating additional funds to the handicraft value chain.

**Mission Response:** On June 25, 2014, the Mission received a sustainability analysis of handicraft project conducted by the implementer DAI (*Attachment B*).

The analysis recommends follow-up on the handicrafts production project through the implementation of Phase 3 by creating marketing linkages and training on business management. It is expected that Phase 3 will require an additional investment of approximately \$7,500 inclusive of training and fees for participation in fairs. The \$7,500 cost will be funded out of other direct costs and short term technical assistance. It is expected that keeping with the same level of return on the women’s labor, i.e. around \$20,000 worth of sales over a six month period, the women will be able to buy new material for production by the last quarter of 2015 and LIVCD will be able to get a 100% return on its investment by the third quarter of 2015. If LIVCD efforts are intensified in terms of market linkage creation, the process could be significantly expedited and the initial investment in the rural women’s human and social capital can start bearing fruit as soon as the first quarter of 2015.

Based on the sustainability analysis of the handicrafts activities, the implementer concurred with the COR request to adopt the sustainability analysis recommendation and report on implementation of the task and results obtained (*Attachment C*).

**Based on the above, the Mission believes that final action has been completed and requests closure of Audit Recommendation No. 2 upon report issuance.**

**Recommendation No. 3:** We recommend that USAID/Lebanon implement procedures to confirm that grant sustainability analyses (as required by the project’s grant manual) are complete and address both financial and operational sustainability.

**Mission Response:** On June 26, 2014, the COR received the outline of the sustainability analysis that will be done for each grant under DAI contract no. AID-268-C-12-00001 (*Attachment D*). This outline includes both financial and operational sustainability analysis. The COR accepted the proposed outline and requested that the implementing partner adopt and implement this analysis for all grants to be issued (*Attachment E*).

**Based on the above, the Mission believes that final action has been completed and requests closure of Audit Recommendation No. 3 upon report issuance.**

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