OFFICE OF INSPECTOR GENERAL

REVIEW OF USAID/WEST BANK AND GAZA'S TRADE PROJECT

REVIEW REPORT NO. 8-294-15-001-S
MARCH 19, 2015

FRANKFURT, GERMANY

Office of Inspector General

March 19, 2015

MEMORANDUM

TO: USAID/West Bank and Gaza, Mission Director, R. David Harden

FROM: Regional Inspector General/Frankfurt, James C. Charlifue /s/

SUBJECT: Review of USAID/West Bank and Gaza's Trade Project
(Report No. 8-294-15-001-S)

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

The final report includes four recommendations to improve the management of USAID/West Bank and Gaza's Trade Project. In its comments on the draft report, USAID/West Bank and Gaza agreed with all four recommendations. Having evaluated management comments, we acknowledge the mission's management decisions on all of them and final action on Recommendations 1, 2, and 3.

Please coordinate final action on Recommendation 4 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 review team during this audit.

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SUMMARY

In March 2013, USAID/West Bank and Gaza awarded a 3-year, $12.2 million contract to Deloitte Consulting to implement the Trade Project. The project aims to stimulate the economic growth of the Palestinian private sector by expanding trade and investment. To maximize its results, the mission designed the project to improve specific aspects of trade. For example, the mission expected its implementer to work closely with private sector associations and firms to identify and analyze opportunities for revenue growth and cost reductions throughout targeted sectors. The project's primary objective is $75 million in annual, recurring cost savings and additional revenues[1] for Palestinian companies.[2]

As of August 2014, nearly the midpoint of the project, mission officials expressed concerns about the lack of progress. The mission director contacted Regional Inspector General/Frankfurt (RIG/Frankfurt) auditors in Tel Aviv on August 12, 2014, and asked for a review. In response, we conducted this review to determine what led Deloitte to implement a turnaround plan for its West Bank and Gaza Trade Project and how Deloitte planned to adjust the project to address USAID/West Bank and Gaza concerns.

We determined that Deloitte (1) implemented a turnaround plan because results for the first year were below expectations and (2) had replaced key staff and, as of September 19, 2014, was revising its work plan. Detailed findings follow:

- Results were far below expectations (page 3). For the first year, they were 4 percent of the target established in the project's performance management plan (PMP). Factors included management and staffing problems, which Deloitte worked quickly to resolve. However, as of September 18, 2014, Deloitte had not revised its work plan or its estimates of cost savings and revenue increases to demonstrate how it planned to reach the $75 million contract deliverable.

- Whether Deloitte would meet its contract objective was unclear (page 5). Project activities and estimates as of September 19, 2014, indicated the project was unlikely to deliver the $75 million in cost savings and additional revenue for Palestinian companies by the end of the contract. Deloitte's process for adjusting its work plan and estimates was ongoing as of the end of this review. Although revisions were pending, we were concerned because $14 million in projected additional revenues for medjool date farmers were not all attributable to project activities, and because Deloitte's results fell short of its past estimates.

- The mission's evaluation mischaracterized the contractor's performance (page 7). Although project staff generally agreed that the project was unsuccessful in the first year, mission officials reported that Deloitte's performance in the first year was satisfactory. Giving misleading information about Deloitte's performance does a disservice to other contracting officers who use this evaluation.

[1] Annual, recurring cost savings and revenue increases is the annual amount of cost savings and revenue increases that will continue in perpetuity.
[2] The project was also expected to build the capacity of six Palestinian organizations to advocate for changes in policies, laws, and institutions' practices. However, because these capacity-building activities were a small part of the project, this review focused on the primary objective.

We recommend that USAID/West Bank and Gaza:

1. Make a written determination of the reasonableness of the updated estimates prepared by the Trade Project (page 6).

2. Make a written determination on whether Deloitte's methodology for recording cost savings and increased revenue is consistent with the Trade Project contract (page 6).

3. Make a written determination whether to terminate or renegotiate the Trade Project contract, and implement that determination (page 6).

4. Revise Deloitte's performance evaluation for the first year of the Trade Project (page 7).

Detailed results follow, and the scope and methodology appear in Appendix I. Our evaluation of management comments is included on page 8 in this report, and the full text of management comments is included in Appendix II.

REVIEW RESULTS

Results Were Far Below Expectations

The contract between USAID/West Bank and Gaza and Deloitte lists the project's primary objective as achieving $75 million in annual, recurring cost savings and increased revenues for Palestinian businesses, at least half of which is cost savings. The contract further states that:

> [t]he Palestinian private sector faces a wide variety of barriers to trade, movement and access, and investment. These barriers, both physical and administrative, introduce direct costs and indirect costs (time and opportunity costs) to economic activity and inhibit competitiveness, profitability, trade, and economic growth.
>
> The success of [Deloitte] will be measured in large part by the concrete economic impact of its activities on the Palestinian private sector. While a list of illustrative activities and outcomes is provided below, [Deloitte] will be given flexibility in terms of the mix of activities that best achieve the results in the Statement of Work.
>
> It is important to note that the economic impact of [Deloitte's] work should be of an enduring nature and produce recurring annual benefits and cost savings. Thus, [the $75 million] is expressed in terms of annual, recurring cost savings and/or additional revenues. The quantitative impacts of changes in policies and procedures due to project activities will be measured in the performance management plan (PMP). [Deloitte] is responsible for thoroughly documenting the link between project activities and a change in policies and procedures that lead to cost savings and/or increased revenues.

The project missed its first-year and midpoint targets. The PMP targeted $25 million in new annual, recurring cost savings and revenue increases by March 21, 2014, which would mean achieving $37.5 million in annual, recurring cost savings by September 21, 2014—the midpoint. However, after 1 year, the project reported only about $1 million in cost savings—4 percent of the project's $25 million target. As of September 19, 2014, the project reported estimated total cost savings and revenue increases of $6.2 million—less than 17 percent of the $37.5 million expected at that point. The table on the following page, provided by a Deloitte official, presents estimates of the cost savings and revenue increases through August 2014.

Through August 2014, Deloitte officials estimated total cost savings and revenue increases for project Year 3 at $48 million—more than $25 million short of the contract deliverable.

Project officials and USAID/West Bank and Gaza officials from the Private Enterprise Office attributed these shortcomings to the conservative way they had calculated cost savings. Officials had recorded only direct costs that they could verify, but officials maintained that systemic changes would directly benefit companies not involved in the project. For example, if a change in policy reduced the number of days a container imported by a West Bank company spent in port, that company would save the direct costs of port storage fees, as well as the indirect costs of having inventory waiting at the port. These costs include any interest paid for the capital invested in dormant inventory, spoilage of perishable goods, and manufacturing stoppage that might occur if a key component were delayed. However, as of September 19, 2014, Deloitte had not adjusted the estimates to account for these factors, and it was unclear whether adjustments would increase cost savings and revenues by the $27 million needed. Still, mission officials anticipated Deloitte would deliver the $75 million required under the contract.

Cost Savings and Revenue Increases Reported Through August 2014 (Unaudited)

Activity	Type	Amount ($)
Increase the number of free days of port storage	Cost savings	2,545,511
Conclude arrangement allowing Unipal to move imported goods from storage before receiving clearance from the Standards Institution of Israel	Cost savings	1,100,080
Increase pallet height for trucks leaving the West Bank through Sha'ar Ephraim crossing going into Gaza	Cost savings	873,383
Obtain approval for containerized imports through the Jalameh crossing point	Cost savings	701,851
Reduce congestion at Sha'ar Ephraim through containerization	Cost savings	521,038
Get permission for containerized exports from the West Bank	Cost savings	330,000
Achieve reductions in the cost of freight forwarding	Cost savings	100,855
Allow telex release of customs documents	Cost savings	32,940
Help Pinar Company implement suggested logistics improvements	Cost savings	18,857
Increase exports to Gaza	Increased revenue	8,360
Work with the Standards Institution of Israel to simplify procedures	Cost savings	6,015
Reach agreement with customs brokers to reduce costs	Cost savings	5,068
Persuade Israeli customs to simplify procedures	Cost savings	2,842
Total		**6,246,799**

Source: Deloitte.

Overreliance on flawed estimates led to shortsighted management decisions. A former project official gave two examples of activities the project had abandoned because estimates indicated they had minimal potential: improving the efficiency of crossing points between territory controlled by the Palestinian Authority and territory controlled by the Government of Israel, and increasing trade with Gaza. According project staff, the estimates did not take into account other direct and indirect cost savings that would result from these activities. Project staff also said these revisions left them frustrated and feeling undermined.

Relations soured when two key staff openly disagreed with project management. Washington-based Deloitte officials terminated both of them in May 2014. However, their removal did not improve the work environment, and in June 2014 the chief of party resigned. Apparently unrelated to these staffing problems, but coinciding with them, the deputy chief of party also left the project.

To address the management and staffing problems identified, Deloitte prepared a turnaround plan and submitted it to the mission on July 15, 2014. We are not making any recommendations in this finding. However, the finding below includes our analysis of the reasonableness of the plan and our recommendations.

Whether Deloitte Would Meet Its Objective Was Unclear

In response to the mission's request to improve program performance, Deloitte moved quickly to replace the project management team and fill the other vacancies. When Deloitte submitted the turnaround plan to the mission on July 15, 2014, the chief of party, deputy chief of party, and all three trade specialist positions needed to be filled; the new acting chief of party and deputy chief of party assumed their roles in August 2014, and one of the three trade specialist positions was filled as of September 15, 2014.

Project activities and estimates as of September 19, 2014, indicated the project was unlikely to deliver the $75 million in cost savings and additional revenue for Palestinian companies by the end of the contract. However, project officials were revising their activities to improve results. Project officials discussed which activities to emphasize during a staff retreat held September 16-17, 2014. After the retreat, project officials planned to draft a new work plan and revise estimates of cost savings and increased revenues that would include both direct and indirect cost savings and increased revenues that previous estimates omitted.

Although RIG/Frankfurt was unable to analyze the revised estimates, which were not available as of September 18, 2014, a cursory review of existing estimates cast doubt on the assumptions behind them. Almost $14 million in cost savings and revenue increases in Year 3 (29 percent) were to come from promoting medjool dates. While promotion efforts might help, the fivefold increase in production that farmers initiated before the project became involved would largely explain any revenue increase. Taking full credit would go against the contract, which clearly states that the reported results should take into account only the revenue increases attributable to project activities.

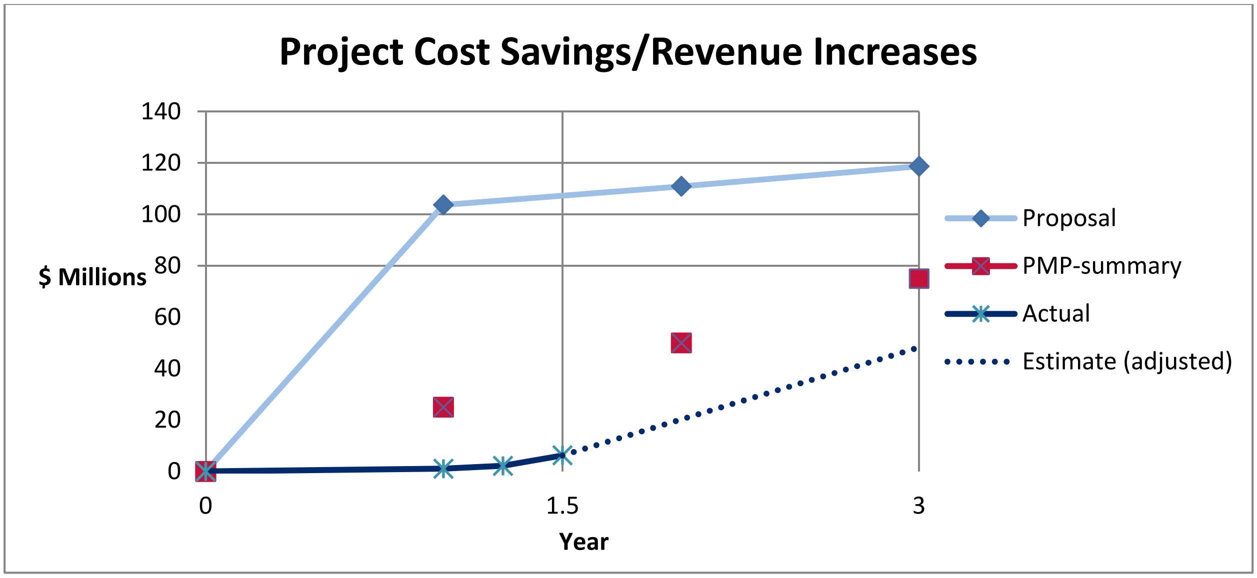
Appropriately, besides asking for this OIG review, the mission's Private Enterprise Office asked USAID's Bureau for Economic Growth, Education, and Environment to conduct a review of Deloitte's underlying assumptions and methodology for creating these estimates. Bureau officials said they would start in early October 2014, but cautioned that there is no industry standard for determining cost savings and that attributing cost savings and increased revenues to project activities is problematic.

Given Deloitte's tendency to set expectations too high, the outlook for meeting the targeted increase in savings and revenue was not good. In its contract proposal, Deloitte claimed it could decrease recurring costs by $71.3 million and increase recurring revenues by $32.4 million, for a total of $103.7 million after the first year (as shown in the figure on the following page).

The mission would face a difficult decision if Deloitte failed to deliver the $75 million in cost savings and increased revenue. The mission could either negotiate a reduction in the fixed-fee contract or continue paying Deloitte's expenses until it achieves its target—neither an ideal option. Contracting officials said that if the mission decided to continue with the project, they could modify the contract to tie the fee amount to the deliverable. Further, the mission could renegotiate the contract so that Deloitte would cover the cost of the turnaround—likely to exceed $50,000.[3]

[3] This is a conservative estimate of the costs of flights; the salary and related costs for the turnaround adviser; and lodging for the turnaround adviser, the new chief of party, and the deputy chief of party.

Differences in Projected Savings and Revenue Increases by Source (Unaudited)



Note: The vertical line at Year 1.5 denotes the project midpoint, September 21, 2014.

Because we were unable to review Deloitte's updated estimates, because of the questionable connection between project activities and the $14 million in additional revenues for medjool date farmers, and because Deloitte's results fell short of its estimates in the past, we make the following recommendations.

> ***Recommendation 1.*** *We recommend that USAID/West Bank and Gaza, based on the Bureau for Economic Growth, Education, and Environment's review of Deloitte's underlying assumptions and methodology, make a written determination of the reasonableness of the updated estimates prepared by the Trade Project.*

> ***Recommendation 2.*** *We recommend that USAID/West Bank and Gaza's Office of Contracts Management make a written determination on whether Deloitte's methodology for recording cost savings and increased revenue is consistent with the Trade Project contract.*

> ***Recommendation 3.*** *We recommend that USAID/West Bank and Gaza make a written determination whether to terminate or renegotiate the Trade Project contract, and implement that determination.*

Mission's Evaluation Mischaracterized Contractor's Performance

Section 42.1502(a) of the Federal Acquisition Regulations requires that federal government contractors be evaluated annually. The contracting officer's representative is responsible for monitoring the contractor's performance and preparing a periodic performance evaluation. Guidance for completing these evaluations states that a satisfactory rating indicates that performance meets contractual requirements with only minor problems and with "NO significant weaknesses identified."

According to project staff, project managers did not provide leadership and managed the project poorly. Staff mentioned that there were frequent conflicts between managers and technical staff and that USAID should have realized the problem earlier. Senior Deloitte officials admitted that the project's outreach to businesses in the first year was not great. Another project employee explained that Deloitte lost credibility with counterparts in the public and private sectors because staff did not coordinate their meetings, and follow-up was inconsistent. He added that because of poor management, he accomplished next to nothing in the first year.

Contrary to the assessment by project staff, mission officials reported that Deloitte's performance in the first year was satisfactory. The performance evaluation in question states, "The Chief of Party is doing a good job balancing various technical, contractual, and political sensitive issues in a professional manner." It adds that Deloitte "has been diligent and successful at meeting with the counterparts in the public and private sectors." Moreover, although the project's contracting officer's representative said that project staff met his expectations for the first year by developing five or six ideas for possible activities, the work plan specified more than a dozen activities and the PMP committed the project to accomplish clearly defined targets. The representative, the office director, and the contracting officer all stood behind the satisfactory ratings given.

Besides giving the impression that the mission does not take Deloitte's poor performance seriously, the positive tone of this evaluation misrepresents Deloitte's performance in the first year of the project. Other contracting officers will use this evaluation, entered into the U.S. Government-wide Contractor Performance Assessment Reporting System, to understand Deloitte's strengths and weaknesses. Therefore, the evaluation must be accurate.

Because of the importance of having accurate evaluations of contractor performance, we make the following recommendation.

> ***Recommendation 4.*** *We recommend that USAID/West Bank and Gaza revise Deloitte's performance evaluation for the first year of the Trade Project.*

EVALUATION OF MANAGEMENT COMMENTS

In their response to the draft report, USAID/West Bank and Gaza officials agreed with all the recommendations. The mission made management decisions on all four and took final action on Recommendations 1, 2, and 3. Final action is pending completion of an interim performance evaluation, which the mission estimated would be completed by April 30, 2015. A detailed evaluation of the comments follows.

Recommendation 1. Mission officials agreed to determine the reasonableness of the updated estimates prepared by the Trade Project. To facilitate this determination, the mission hired an independent expert. After reviewing the expert's findings, officials determined that the estimates were unreliable and overstated cost savings. We acknowledge the mission's management decision and final action.

Recommendation 2. Mission officials agreed to determine whether the project's methodology for recording cost savings and increased revenue was consistent with the contract. Officials determined that the methodology was consistent with the contract but was incorrectly applied. We acknowledge the mission's management decision and final action.

Recommendation 3. Mission officials agreed to determine whether to terminate or renegotiate the Trade Project contract. In keeping with the determination made under Recommendation 1, they decided to terminate the project for convenience effective March 1, 2015. We acknowledge the mission's management decision and final action.

Recommendation 4. Mission officials agreed to revise Deloitte's performance evaluation but said they could not amend the evaluation already in the system. Rather, they initiated an interim evaluation for the period from March to September 2014 to document Deloitte's performance under this project. Their response addresses the spirit of this recommendation, and, accordingly, we acknowledge the mission's management decision. Final action is pending the completion of the interim evaluation, which the mission estimated it would finish by April 30, 2015.

SCOPE AND METHODOLOGY

Scope

RIG/Frankfurt conducted this review in accordance with the generally accepted government auditing standards in Chapter 3 of *Government Auditing Standards* and with the documentation, evidence, and finding development standards in Sections 6.56 through 6.82. They require that we obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with our review objective. We believe that the evidence obtained provides that reasonable basis.

This review was conducted to determine what led Deloitte to implement a turnaround plan for its West Bank and Gaza Trade Project and how Deloitte planned to adjust the Trade Project to address USAID/West Bank and Gaza concerns.

The review covered the period from March 21, 2013, to September 19, 2014. During this period the USAID mission to West Bank and Gaza obligated $6.5 million and disbursed about $3.8 million for the Trade Project.

RIG/Frankfurt conducted this review at the USAID/West Bank and Gaza office in Tel Aviv and at the Deloitte office in Ramallah from September 4 to 23, 2014.

Methodology

To answer the review objective questions, RIG/Frankfurt interviewed the following officials:

- Deloitte:
  - Original chief of party
  - New management team, including the new acting chief of party
  - Terminated senior trade specialist
  - Current logistics solutions specialist
  - Two project consultants
  - Three members of the monitoring and evaluation team
  - Current finance manager

- USAID/West Bank and Gaza:
  - Private enterprise office director
  - Contracting officer's representative
  - Alternative contracting officer's representative
  - Mission director
  - Contracting officer
  - Procurement specialist
  - Deputy controller
  - Program officer

- Standards Institution of Israel: Deputy director for customer relations

- Palestine Standards Institute: Director General

In addition to conducting these interviews, we reviewed the contract, project performance reports, the PMP, the turnaround plan, monitoring and evaluation tools, preaward documentation, and billing documents.

We reviewed the documentation and the testimonial evidence collected to answer the review objectives. In addition, we tested the estimate of annual recurring cost savings and revenue increases provided by Deloitte for reasonableness, including recalculating these estimates and reviewing the underlying assumptions for a judgmental sample of activities. However, we did not audit these figures to provide any level of assurance about their estimates, and, accordingly, we did not rely on these estimates to answer the review objectives.

MANAGEMENT COMMENTS

UNCLASSIFIED

MEMORANDUM

DATE: January 30, 2015

TO: Regional Inspector General/Frankfurt, James C. Charlifue

FROM: Mission Director, USAID/West Bank & Gaza, R. David Harden /S/

SUBJECT: Response to Review of USAID/West Bank and Gaza's Trade Project (Report No. 8-294-15-00X-S)

Thank you for your draft report, dated December 5, 2014, which was issued in response to my request, dated August 12, 2014, for a review of our Trade Project with Deloitte Consulting. We accept and agree with all of the recommendations and intend to terminate the entire contract for convenience effective March 1, 2015.

In response to the specific recommendations:

*"**Recommendation 1**. We recommend that USAID/West Bank and Gaza, based on the Bureau for Economic Growth, Education, and Environment's review of Deloitte's underlying assumptions and methodology, make a written determination of the reasonableness of the updated estimates prepared by the Trade Project."*

Response: The Mission agrees with the need for such a determination. Since the Bureau for Economic Growth, Education, and Environment had some prior involvement in the design of the project, the Mission procured the services of an independent expert with significant experience in evaluating trade models and with no prior involvement in the project to make such a determination. In January 2015, an independent assessment was undertaken to specifically ascertain the validity of Deloitte's updated estimate of $21 million in direct and indirect impacts due to the Trade Project's activities from March 21, 2013 to September 30, 2014.

The expert delivered his final report on January 26, 2015 and determined in his Executive Summary that:

"(He) does not support the claim that the Trade Project's interventions over the March 2013 to September 2014 period have resulted in cost savings and income benefits of $21 million," … ".the survey results are not reliable…", and "the GCE (computable general equilibrium) model (the economic model used to measure impact) … overestimates these cost savings and income effects …”.

The assessor’s findings validate the Mission’s concerns about the accuracy of Deloitte’s estimates.

*“**Recommendation 2**. We recommend that USAID/West Bank and Gaza’s Office of Contracts Management make a written determination on whether Deloitte’s methodology for recording cost savings and increased revenue is consistent with the Trade Project contract.”*

Response: USAID/West Bank and Gaza’s Office of Contracts Management found Deloitte’s model consistent with the contract, but that it was incorrectly applied for the measurement of indirect cost savings, thereby calling into question the measurement of total savings achieved to date, as well as future savings. The Mission considered this as a factor in making the determination to terminate the contract.

*“**Recommendation 3**. We recommend that USAID/West Bank and Gaza make a written determination whether to terminate or renegotiate the Trade Project contract, and implement that determination.”*

Response: Based on the expert’s report, internal deliberations and funding constraints, we intend to terminate the entire contract for convenience effective March 1, 2015.

*“**Recommendation 4**. We recommend that USAID/West Bank and Gaza revise Deloitte’s performance evaluation for the first year of the Trade Project.”*

Response: While the Mission cannot retroactively amend a Contractor Performance Assessment Report (CPAR) performance evaluation that has already been submitted into the system, we have initiated an interim CPAR evaluation for the period of March through September 2014. This interim CPAR will provide the Mission project management team the opportunity to review and record in CPARS Deloitte’s performance after the first year of the Trade Project.

Thank you again for your team’s work and assistance in this matter. Please do not hesitate to contact me if you have any questions.

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