



USAID
FROM THE AMERICAN PEOPLE

OFFICE OF INSPECTOR GENERAL

FOLLOW-UP AUDIT OF USAID/PERU'S ALTERNATIVE DEVELOPMENT PROGRAM

AUDIT REPORT NO.1-527-08-003-P
MARCH 25, 2008

SAN SALVADOR, EL SALVADOR



March 25, 2008

MEMORANDUM

TO: USAID/Peru Mission Director, Paul Weisenfeld
USAID/Peru Regional Contracting Officer, Erin Elizabeth McKee

FROM: Regional Inspector General/San Salvador, Timothy E. Cox /s/

SUBJECT: Follow-Up Audit of USAID/Peru's Alternative Development Program
(Report No. 1-527-08-003-P)

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

The report contains eight recommendations intended to improve accountability and implementation of the Alternative Development Program. Based on your comments and documentation provided, final action has been taken on Recommendation Nos. 2, 3, 4, and 8. A management decision for Recommendation No. 1 can be reached when USAID/Peru provides timeframes to complete the contracted financial review. A management decision for Recommendation Nos. 5 and 7 can be reached when USAID/Peru makes a final determination of the amount of questioned costs to be recovered. Finally, a management decision for Recommendation No. 6 can be reached when USAID/Peru and RIG/San Salvador agree on the actions to be taken, including the timeframes to complete the actions. Determination of final action on the recommendations currently without final action will be made by the Audit Performance and Compliance Division (M/CFO/APC).

I appreciate the cooperation and courtesy extended to my staff throughout the audit.

CONTENTS

Summary of Results	1
Background	4
Audit Objectives	5
Audit Findings	7
Where the actions taken by USAID/Peru in response to recommendations in Audit Report No. 1-527-06-001-P effective?	7
Lists of Heads of Households Were Inflated	12
Did USAID/Peru's Alternative Development Program activities achieve current performance targets and what has been the impact?	16
Some Program Results Were Overstated	18
Appendix I – Scope and Methodology	22
Appendix II – Management Comments	24

SUMMARY OF RESULTS

The U.S. Government's counternarcotics strategy in Peru has three elements: (1) interdiction, (2) eradication aimed at disrupting narcotics trafficking, and (3) alternative development. The U.S. Agency for International Development/Peru (USAID/Peru) plays a leading role in the fourth element of the strategy—alternative development, or helping families replace coca cultivation with alternative licit crops and other income-generating activities. (See page 4.) On December 13, 2005, the Regional Inspector General/San Salvador (RIG/San Salvador) issued an audit report (Audit Report No. 1-527-06-001-P) on USAID/Peru's Alternative Development Program that included 16 recommendations to USAID/Peru. (See page 5.)

As part of its fiscal year 2008 audit plan, the Regional Inspector General/San Salvador performed the current audit to answer the following questions (see page 5):

- Were the actions taken by USAID/Peru in response to recommendations in Audit Report No. 1-527-06-001-P effective?
- Did USAID/Peru's Alternative Development Program activities achieve current performance targets and what has been the impact?

With respect to the first question, USAID/Peru effectively addressed 12 of the 16 original audit recommendations. (See page 7.) However, the mission's actions to address one recommendation were not effective and actions to address three recommendations were only partially effective:

- The mission has not developed a better strategy for verifying that all coca in the communities participating in the program has been eradicated. Although the agreements with the communities require eradication of all coca in each community, USAID/Peru and its contractor have informally decided to tolerate some continued coca cultivation in the communities, hoping that the holdouts will join the program at a later date. The mission's actions were partially effective. (See page 7.)
- In response to a recommendation to transition the cash payments program to other forms of assistance that better promote sustainable income-generating activities, the mission and its contractor decided to continue the cash payments but reduced their amount from \$180 to \$100 per family. Because of evidence of fraudulent and ineligible payments totaling an estimated \$2.9 million, this audit concludes that the mission's actions in response to this recommendation were not effective. (See page 9.)
- In response to another recommendation concerning cost control, USAID/Peru limited assistance to \$2,000 per hectare of coca eradicated but then did not monitor compliance with the limit, which was exceeded in 38 percent of the cases reviewed. The mission's actions were only partially effective. (See page 10.)
- Finally, the mission and its contractor established a requirement for communities to make cost-sharing contributions, but the mission's contractor did not uniformly enforce the requirement and only half of the 50 projects reviewed received any cost-sharing contributions. The mission's actions in response to the original recommendation were only partially effective. (See page 11.)

With respect to the Alternative Development Program's current performance and impact (the second question above), the program is meeting performance targets for voluntary eradication of coca and substantially met a FY 2006 target for the percentage of families in program areas that believe coca should be eliminated from their communities. The program's performance with respect to other important performance targets is unclear because of evidence that lists of beneficiary heads of households have been inflated. (See page 16.) Inflation of lists of heads of households led to inflation of the award fee paid to the contractor and cash payments to beneficiaries. As such, we have recommended that the mission reassess the almost \$1.4 million in fees already awarded to the contractor as well as \$2.9 million in cash payments to beneficiaries who were potentially ineligible to receive such payments.

Despite these deficiencies, the program has had a positive effect on over 800 rural Peruvian communities and thousands of families. The overall U.S. counternarcotics strategy in Peru has also been positively impacted by the program which has helped families develop alternative licit means of income in lieu of replanting coca, thus increasing the long-term sustainability of the strategy.

This report contains the following recommendations for USAID/Peru:

- Arrange for an agency-contracted audit to purge fictitious names and ineligible individuals from the lists of heads of households. (See page 15.)
- End the practice of adding names to community lists in violation of the community agreements. (See page 15.)
- Ensure that Chemonics has implemented controls to reasonably ensure that cash payments are only made to eligible heads of households in assisted communities. (See page 15.)
- Establish procedures to periodically validate the accuracy of the lists of heads of households. (See page 15.)
- Make a management decision with regard to the questioned costs of \$2,936,139 in cash payments made to individuals who were ineligible to receive such payments, and recover from Chemonics the amounts determined to be unallowable. (See page 15.)
- Revise reported results on number of families that agree to eliminate their coca, and the number of families that remain coca free based on the completion of actions taken in response to Recommendation No. 1. (See page 20.)
- Review the award fee paid to Chemonics and make a management decision with regard to the ineligible questioned costs of \$1,395,413 in award fees paid for achievement of performance targets. (See page 20.)
- Establish procedures to periodically validate the results reported by Chemonics. (See page 20.)

USAID/Peru agreed to implement seven of the eight recommendations in the report. However, the mission stated that it was unfortunate that the report devotes such a small space to the successes of the program and suggested several changes to specific sections of the report. We have made these changes where appropriate. Our

evaluation of management comments is provided after each finding in the report, and USAID/Peru's comments in their entirety are included in Appendix II.

BACKGROUND

The U.S. Government has made a large commitment to fighting drug production and narcotics trafficking throughout the Andean Region. Peru ranks second behind Colombia and ahead of Bolivia in the cultivation of coca, with 51,400 hectares under coca production in 2006. This represents a 7 percent increase from 48,200 hectares in 2005.¹ Coca has long been produced in Peru for traditional use by segments of the highland population. However, the amount of coca used for legal purposes is a small percentage of the coca actually grown, as the majority of the coca is sold to narcotraffickers. The U.S. Government's long-term counternarcotics strategy in Peru is composed of three elements: interdiction, eradication, and alternative development. USAID/Peru takes the lead in implementing alternative development activities.

USAID and the Government of Peru's counternarcotics organization, the *Comisión Nacional para el Desarrollo y Vida Sin Drogas* (DEVIDA), signed a bilateral agreement in September 2002 to implement the Alternative Development Program. DEVIDA is charged with coordinating, planning, promoting, monitoring, and evaluating the "national strategy to fight against narcotics" as well as coordinating the technical and programming inputs from several Government ministries involved with law enforcement and development.

The Alternative Development Program is implemented primarily through a contract with Chemonics International, Inc., and also through coordination with other entities. Chemonics' role is to manage the implementation process; to ensure that implementation is carried out in a coordinated, transparent, and rapid manner in accordance with USAID rules and regulations; and to ensure that the agreed-upon activities are achieving the anticipated results and impacts. Chemonics works with community leaders and potential program beneficiaries to encourage communities to commit to voluntary coca eradication in exchange for cash payments, assistance in the development of alternative licit crops, and infrastructure projects. After convincing communities to voluntarily eradicate their coca crops and become part of the Alternative Development Program, Chemonics then has the agreements formally signed by community leaders and DEVIDA. Once the communities sign the agreements pledging to be 100 percent coca free, Chemonics makes the cash payments to community heads of households and enters into subawards (contracts and grants) to local organizations to implement the activities stipulated in the agreements. These activities include construction of social and economic infrastructure as well as technical assistance to develop sustainable economic activities as alternatives to coca production. The Chemonics award estimated total contract cost is \$116,540,765 and the performance period extends through March 31, 2008. As of September 30, 2007, approximately \$106.4 million had been obligated with disbursements of \$31 million and \$29 million in FY 2006 and 2007 respectively.

In addition, USAID and Chemonics entered into another contract effective October 1, 2007, totaling almost \$80 million and serving as the principal mechanism for implementing the Alternative Development Program for the period from 2008 to 2012. Through this new contract, the focus of the program will shift from encouraging voluntary eradication to helping communities and families transition to a licit lifestyle after forced eradication by the Government of Peru. The contract also aims to sustain and

¹ Information obtained from the United Nations Office of Drugs and Crime annual report for Peru, dated June 2007.

consolidate gains already achieved in over 800 communities that agreed to voluntary eradication since 2002 (see map on page 6).

An important component of the Alternative Development Program is strengthening the capabilities of the Government of Peru agencies charged with implementing counterdrug policies and legislation, mainly DEVIDA. In 2002, USAID signed a contract with Development Alternatives, Inc. (DAI), to implement the policy and institutional development component of the Alternative Development Program through 2005. To continue this policy and institutional capacity building work, USAID entered into a second contract with DAI in July 2005, providing \$4.1 million for activities through July 2008.

DEVIDA is the primary Peruvian governmental institution charged with establishing counterdrug policy and coordinating the implementation of this policy among government entities, bilateral and multilateral donors, and nongovernmental organizations. The State Department's Narcotics Affairs Section (NAS) and the Government of Peru's agency for forced eradication CORAH (*Control y Reducción de la Coca en el Alto Huallaga*) are responsible for forced eradication and interdiction measures involving communities that are not willing to undertake voluntary eradication. CADA (*Cuerpo de Asistencia para el Desarrollo Alternativo*), funded by USAID, is a Government of Peru entity responsible for identifying communities with coca production and measuring coca fields before and after eradication.

In September 2005, RIG/San Salvador conducted an audit of USAID/Peru's Alternative Development Program to determine whether activities were on schedule to meet planned results and whether activities were implemented efficiently. The audit report (Report No. 1-527-06-001-P, dated December 13, 2005) reported on several issues affecting implementation of the program and made 16 recommendations to improve the program. This FY 2008 follow-up audit was conducted to determine whether effective actions were taken by USAID/Peru to implement the recommendations in our 2005 audit report. This audit also looked at the program's current progress toward achieving its performance targets since the 2005 audit.

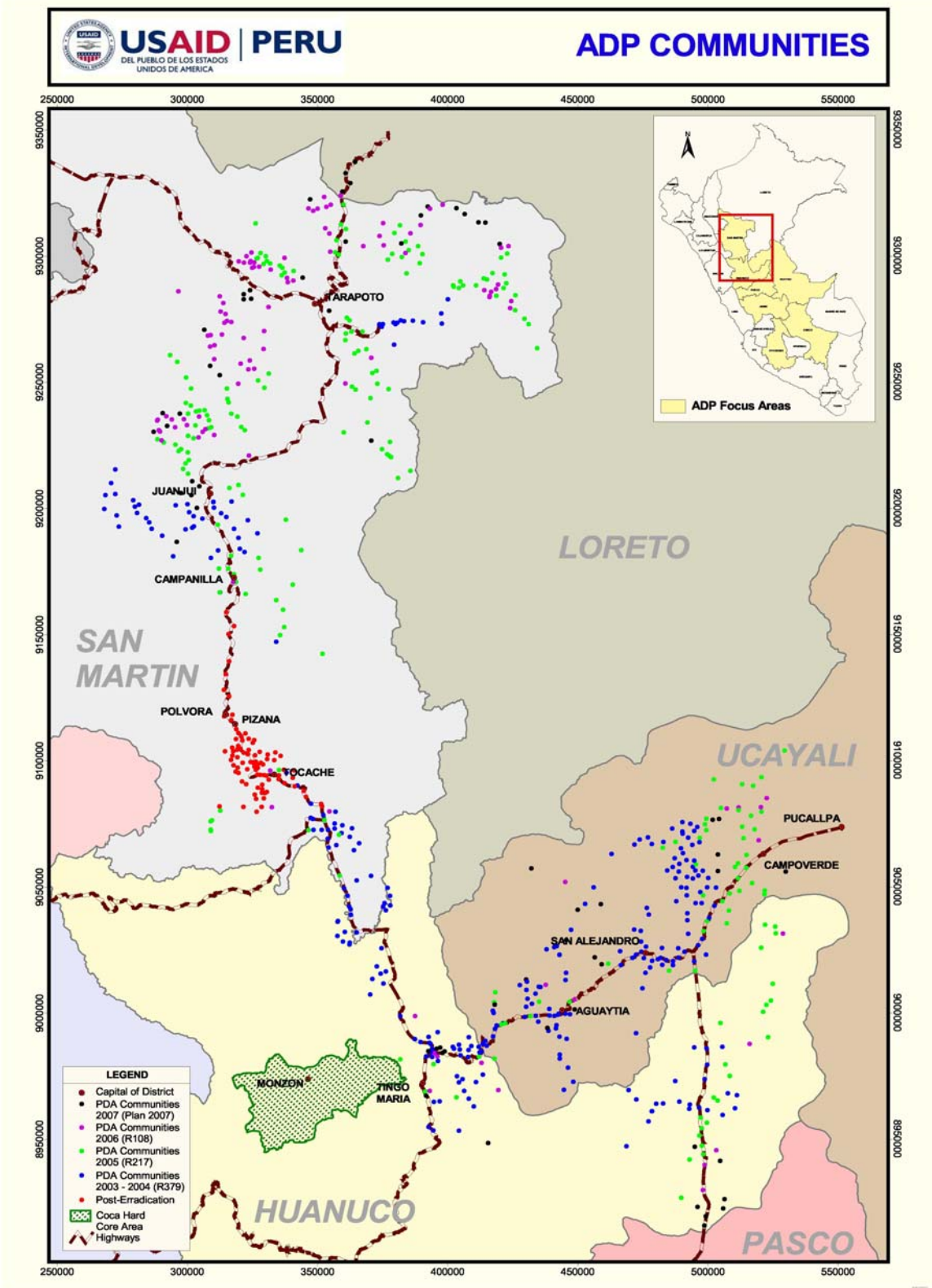
AUDIT OBJECTIVES

As part of its FY 2008 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions:

- Were the actions taken by USAID/Peru in response to recommendations in Audit Report No. 1-527-06-001-P effective?
- Did USAID/Peru's Alternative Development Program activities achieve current performance targets, and what has been the impact?

Appendix I contains a discussion of the audit's scope and methodology.

Map of USAID/Peru's Alternative Development Program (ADP) Communities.



AUDIT FINDINGS

Were the actions taken by USAID/Peru in response to recommendations in Audit Report No. 1-527-06-001- P effective?

USAID/Peru responded to all of the recommendations detailed in the original audit report referenced above. RIG/San Salvador determined that the mission's actions in response to 12 of the 16 recommendations were effective. However, the mission's actions in response to four other recommendations were not effective (see Recommendation No. 7 below) or were only partially effective (see Recommendation Nos. 2, 13, and 14 below). The following paragraphs discuss the recommendations made in the original report, the mission's actions taken on those recommendations, and conclusions concerning the effectiveness of the mission's actions.

Original Recommendation No. 1 – We recommended that USAID/Peru develop an action plan along with the State Department's Narcotics Affairs Section (NAS) to obtain needed support from the Government of Peru (GOP).

In response to the recommendation, the mission stated that NAS, USAID, and other U.S. Government agencies have worked closely with GOP counterparts on the development of a multiyear "nationalization" of counternarcotics efforts. Our discussions with officials at the U.S. Department of State, United Nations, CADA (*Cuerpo de Asistencia para el Desarrollo Alternativo*), DEVIDA (*Comisión Nacional para el Desarrollo y Vida Sin Drogas*), and NAS support the mission's assertion that there is high degree of cooperation between the different organizations. The GOP's commitment is also evidenced by the development of a strategy to garner support among GOP agencies for counternarcotics efforts and to change the tone of domestic discussions on the drug problem. This strategy has produced significant progress in convincing Peru's antidrug agency, DEVIDA, to assume greater responsibility. GOP support is also demonstrated by its forced eradication program, which exceeded its eradication target. Finally, GOP support is evidenced by approval of DEVIDA's *Plan de Impacto Rápido* (PIR) for 2008, including approval of an additional \$21 million for the program. The PIR provides funding for 15 GOP ministries and agencies involved in counternarcotics activities, in addition to DEVIDA. On this basis, this audit concludes that the mission's actions in response to Recommendation No. 1 were effective.

Original Recommendation No. 2 – We recommended that USAID/Peru, in coordination with the State Department's Narcotics Affairs Section (NAS), CADA (*Cuerpo de Asistencia para el Desarrollo Alternativo*), DEVIDA (*Comisión Nacional para el Desarrollo y Vida Sin Drogas*), and Chemonics, develop a better strategy for targeting communities with high concentrations of coca fields and verifying that all coca grown in the communities has been eradicated.

The first part of this recommendation, dealing with targeting high concentrations of coca, is no longer relevant, since under the new program beginning in October 2007 USAID will no longer be involved in identifying communities with concentrations of coca and persuading them to sign voluntary eradication agreements. Instead, USAID will help communities transition to licit livelihoods after forced eradication by CORAH (*Control y Reducción de la Coca en el Alto Huallaga*).

The second part of the recommendation, verifying that all coca in the communities had been eradicated, was not implemented. The program mainly relies on communities and

families to declare their own coca parcels, and there is no systematic checking or verification to ensure that all coca is declared by communities. The mission argues that there is no practical way to verify how much coca is being grown in the communities it works with, since the coca plots are relatively small and dispersed. The mission stated that it has tried several different verification methods, including aerial photography, satellite imagery, and having teams walk through and around communities in formation with team members maintaining fixed intervals between one another (e.g., one team member every 25 meters). The mission's evaluation of these methods was that they were too time consuming, impractical, or not cost efficient, and we have no contradictory evidence to present.

Another reason why verification has not been strengthened is that USAID/Peru and Chemonics have informally decided to tolerate continued small-scale cultivation of coca in communities that participate in the program, despite signed agreements with communities that stipulate that the community is to eradicate all illegal coca that exists in the community and remain 100 percent coca free. USAID/Peru and Chemonics reason that, as community members see program benefits being delivered, voluntary eradication may become more attractive to them. Again, this audit has no contradictory evidence to present, but RIG/San Salvador is uncomfortable with the practice of requiring 100 percent compliance and then ignoring widespread noncompliance.

A related issue is that it has become extremely common for communities to add beneficiaries and coca plots to community agreements through addendums, even though this practice is prohibited by the agreements themselves. For FY 2006 and FY 2007, the number of hectares added through addendums represents 32 percent and 84 percent, respectively, of the total hectares reportedly eradicated under the program. (See related audit findings beginning on pages 12 and 18.)

This audit concludes that the mission's actions to implement the recommendation were only partially effective.

Original Recommendation No. 3 – We recommended that USAID/Peru seek agreements from communities to eradicate all of their coca at one time, not in phases.

This recommendation was intended to address situations where CADA had to return to communities several times as community members eradicated their “declared” coca in stages. This audit concludes that the mission's actions were effective as virtually all communities have chosen to eradicate all of their declared coca at once.

Original Recommendation No. 4 – We recommended that USAID/Peru increase the weight assigned to achieving results (for hectares of coca eradicated and the number of clients who remain coca free) to at least 50 percent of the award fee pool.

In July 2006, the mission adjusted the contractor's award fee plan as recommended. Therefore, this audit concludes that the mission's actions to implement the recommendation were effective.

Original Recommendation No. 5 – We recommended that USAID/Peru (a) modify its contract with Chemonics International, Inc., to reflect the revised target for number of hectares of coca voluntarily eradicated, and (b) ensure that the revised target is consistent among mission documents.

This audit concludes that the mission's actions to address the recommendation were effective after verifying that the mission modified the Chemonics contract to reflect the

revised target. Since the new program strategy does not involve voluntary eradication, RIG/San Salvador determined that there was no need to pursue this issue further.

Original Recommendation No. 6 – We recommended that USAID/Peru establish voluntary eradication targets for calendar years 2006 and 2007 that are achievable and realistic, but not set so low that they become irrelevant to the program objectives.

This audit concludes that the mission's actions to address the recommendation were effective, based on our verification that the voluntary eradication performance targets were revised to realistic levels.

Original Recommendation No. 7 – We recommended that USAID/Peru develop a plan to transition the cash payment program into a program that promotes more sustainable income generation.

In response to the recommendation, the mission and Chemonics decided to continue cash payments while reducing their amount from \$180 to \$100 per head of household. Subsequently, Chemonics, through the monitoring and evaluation team, detected irregularities in a specific geographic region. Chemonics hired an audit firm to review the cash payments in 13 communities. The audit firm discovered numerous irregularities in that cash payments were improperly paid based on inflated lists of heads of households that included fictitious names, names of minor children, and names of people who do not live in the communities. There is evidence that beneficiary lists, which serve as the basis for cash payments and for reporting program accomplishments, have also been inflated in other regions. Therefore, this audit concludes that the mission's actions in response to the recommendation were not effective. (See a related audit finding that begins on page 12.)

Original Recommendation No. 8 – We recommended that USAID/Peru (a) ensure that the program can deliver infrastructure projects before signing agreements with communities, (b) provide clear boundaries to its implementing partners (Chemonics and DEVIDA) on what can be promised to communities, and (c) modify the standard agreements with communities to include language stating that the infrastructure projects can only be delivered after necessary environmental assessments are performed.

This audit concludes that the mission's actions to address the recommendation were effective, since (1) the mission provided clear guidance to the contractor on what kinds of infrastructure projects are allowable in negotiations with communities and direction on selecting projects that are deliverable, and (2) the mission revised the standard agreement to include a clause that states that all infrastructure projects are subject to an environmental assessment before implementation.

Original Recommendation No. 9 – We recommended that USAID/Peru verify and document that Chemonics establishes and enforces policies that describe the types of infrastructure works that contribute to the program goal of generating licit economic activities and therefore may be financed with program funds.

This audit concludes that the mission's actions to address the recommendation were effective, based on the mission providing and enforcing guidance to Chemonics on the types of infrastructure works that can be negotiated with communities.

Original Recommendation No. 10 – We recommended that USAID/Peru ensure that (a) community agreements require communities to develop and implement maintenance

plans, (b) Chemonics helps communities to develop the plans, and (c) the potable water system in Ricardo Palma, Peru, is repaired.

This audit concludes that the mission's actions to address the recommendation were effective, based on (1) Chemonics requiring its subcontractors to ensure that communities establish maintenance committees and develop maintenance plans, and (2) the mission ensuring that the potable water system in Ricardo Palma was repaired.

Original Recommendation No. 11 – We recommended that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$225,037 (concerning benefits paid to noncompliant communities after USAID directed Chemonics to suspend benefits) and recover from Chemonics the amounts determined to be unallowable.

In response to the recommendation, USAID/Peru determined that apparent payments after the suspension was ordered reflected a record-keeping problem at Chemonics rather than any actual payments contrary to USAID instructions. Therefore, the mission deemed the \$225,037 in questioned costs to be allowable. This audit concludes that the mission's financial and contracting staff satisfactorily addressed the recommendation by conducting a review of the questioned costs, including additional documentation provided by the contractor, in making its final determination.

Original Recommendation No. 12 – We recommended that USAID/Peru limit benefits to communities until the communities completely eradicate their coca fields.

The context of this recommendation was that the program previously provided benefits to communities immediately after they signed voluntary eradication agreements, even though there was no assurance that communities would comply with the agreements by actually eradicating their coca.

In response to the recommendation, the mission and Chemonics decided that voluntary eradication would take place simultaneously with negotiation of new agreements with communities. Our review of 59 of the 260 communities signing agreements in FY 2006 and 29 of the 120 communities signing agreements in FY 2007 determined that, with only limited exceptions, benefits were not provided to communities until after eradication of all declared coca. This audit concludes that the mission's actions in response to the recommendations were effective in limiting benefits until "declared" coca is eradicated. (However, as discussed above under Original Recommendation No. 2, the program does not systematically verify that all coca in a community has been declared or eradicated.)

Original Recommendation No. 13 – We recommended that USAID/Peru (a) establish a reasonable limit on the investments made in the communities and (b) verify compliance with the limits.

In response to this recommendation, the mission set a limit of \$2,000 per hectare of coca eradicated but did not verify compliance with the limit. As a result, 98 of the 260 communities that signed voluntary eradication agreements in FY 2006 (38 percent) received an investment greater than the established \$2,000 per hectare limit. We concluded that the mission's actions in response to this recommendation were only partially effective. Because the program will no longer be involved in identifying communities with concentrations of coca and persuading them to sign voluntary eradication agreements, this audit is not making any recommendation.

Original Recommendation No. 14 – We recommended that USAID/Peru require communities to contribute to infrastructure projects by entering into cost-sharing agreements with communities.

In response to this recommendation, USAID/Peru and Chemonics established that all communities that agreed to participate in the Alternative Development Program after FY 2005 would be required to present a counterpart contribution to its chosen infrastructure project. In-kind contributions, such as unskilled labor and materials, are acceptable. Chemonics outlined this policy in its 2006 strategy, and determined that, ideally, program resources will not account for more than 30 percent of the total project cost.

However, a Chemonics official explained that communities are only asked to contribute to infrastructure projects but are not obligated to do so. Our review of 50 community projects in FY 2006 and FY 2007 showed that only 50 percent received community contributions. Therefore, this audit concludes that the mission's actions in response to the recommendation were only partially effective. Because the mission stated that it obtains contributions from communities based on ability to pay, RIG/San Salvador is not making a recommendation.

Original Recommendation No. 15 – We recommend that USAID/Peru (a) assess the level of staffing and salaries needed to implement the program, and (b) monitor and ensure that Chemonics International, Inc., will transition its international staff as intended.

In response to the recommendation, the mission agreed to analyze the staffing needs of Chemonics' Alternative Development Program. A revised staffing plan was developed by Chemonics, and a timeline of staff departures was put in place to achieve the new staffing levels. In addition to reducing overall levels of staffing, several expatriate positions were scheduled to be eliminated and transitioned to local staff.

Reductions of local staff began in FY 2006 with the local staff being reduced from 220 at the time of our previous audit to 187 on November 1, 2007. The current staffing plan calls for only 124 employees by March 2008. Six expatriate staff positions have been converted to local staff positions and the staffing plan for the new contract identifies the need for a total of 141 employees.

This audit concludes that the mission's actions in response to this recommendation were effective.

Original Recommendation No. 16 – We recommended that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$2,487 and recover from Chemonics International, Inc., the amounts determined to be unallowable.

During the 2005 audit, the auditors noted several instances where Chemonics' local employees had received salary increases within a few months of receiving another approved salary increase. The justifications for the salary increases were unacceptable to both the auditors and to USAID/Peru.

In response to the recommendation, a mission procurement analyst analyzed the salary awarded to Chemonics employees to determine if they complied with USAID/Peru policy. As a result of the analysis, USAID/Peru identified ineligible costs of \$18,813. This amount was collected from Chemonics in May 2006. We conclude that the actions taken by the mission were effective.

The following section discusses inflated lists of beneficiaries that resulted in unnecessary costs to the program.

Lists of Heads of Households Were Inflated

Summary: The Alternative Development Program has provided assistance and benefits to families in 802 communities based on community lists of heads of households. These community lists are used to report on two of the four main performance measures of program success and are also used to make cash payments to beneficiaries in the program. A review by a local auditing firm of 13 communities in one region estimated that 78 percent of the names represented fictitious names, names of minors, and names of people not residing in the community. There is evidence that lists of heads of households have also been inflated in other regions, although no examination has been undertaken to identify all such cases. One common method used to add names to the community lists was through addendums to agreements, even though the original agreements specifically prohibit this practice. This practice led to the addition of 18,115 families on communities' lists, representing 28 percent of the total families reported under the program. This occurred because Chemonics lacked sufficient controls and because Chemonics, with USAID/Peru's knowledge and support, did not adhere to the provision of the community agreements that prohibited changes to the list of heads of households. In some cases, Chemonics' staff allegedly promoted these methods to meet program targets on the number of families that formally agree to eliminate their coca and the number of hectares of coca eradicated. As a result, the program paid \$2,936,139 more in benefits than it should have. In addition, program results reported by the mission and Chemonics were overstated, which led to paying more in performance award fees than necessary.

Chemonics develops lists of heads of households in each community and uses these lists to make cash payments to families participating in the Alternative Development Program. It also uses these lists to report on two of the four main performance indicators for the program: the number of families that formally agree to eliminate their coca, and the number of alternative development families that remain coca free. The agreements signed with each community state that the list of heads of households, once developed and incorporated into each agreement as an annex, cannot be modified through additions or deletions. Given the key role that the lists play in the program, it is important that the lists be accurate.

However, the lists have been inflated to include fictitious names, names of minor children, and names of people who do not live in the communities assisted by Chemonics. In response to suspected improper practices uncovered by the Chemonics Monitoring and Evaluation Unit in October 2006, Chemonics hired a local auditing firm to review the community lists in the Ucayali region. Based on a judgmental sample of 13 of the 185 communities assisted by Chemonics in the region (these 13 communities were specifically selected based on suspicions of fraudulent practices), the audit firm estimated that 2,420 of the 3,114 heads of households listed in these communities represented fictitious names, minor children, or people from outside the communities and that only 674 heads of households should have been on the lists for the 13 communities. The audit firm found that, while the original community lists were substantially inflated, most of the fictitious names were added through modifications to the original lists, a practice that was not allowed by the agreements themselves. In the 13 communities, 1,912 names had been added to the original lists. According to the audit firm, Chemonics employees responded to pressure to meet performance targets by encouraging community members to subdivide their parcels of coca and list other individuals as owners. The community members would then use falsified powers of

attorney to collect multiple cash payments on behalf of the other “owners.” During site visits to six additional communities in the Ucayali region, RIG/San Salvador confirmed that these communities were using similar methods allegedly promoted by Chemonics staff to inflate community member lists and to allow them to obtain more cash payments.

There is evidence that lists of heads of households have also been inflated in other regions, although no examination has been undertaken to identify the extent of the problem. Chemonics monitoring and evaluation reports dating back to 2004 alerted Chemonics management to similar schemes to obtain cash payments in the Aguaytia and Tocache regions. These reports mentioned possible cases where community members subdivided parcels of coca to obtain additional cash payments and included spurious names on the lists. In 2004, Chemonics identified 45 individuals in the Aguaytia region that had collected double payments by getting on the list of heads of households in the community where they resided, as well as on the list in a neighboring community. In another case, the Chemonics Monitoring and Evaluation Unit detected payments to 52 individuals who did not live in the community where they were listed.

As mentioned above, the local auditing firm discovered that spurious names were commonly added by modifying the original lists of heads of households, even though the community agreements specifically prohibit this practice. Data from Chemonics shows that program-wide, the practice of adding names through addendums to original community lists resulted in the addition of 18,115 names, representing 28 percent of the total families reported as receiving assistance under the program. Again, no examination has been undertaken to determine how many of the additional names represented minor children, people from outside the assisted communities, or fictitious names. However, a review of communities’ lists revealed numerous cases in all regions where the number of families added through addendums greatly exceeded the number of families on the original lists. A few examples are shown in the following table.

Table 1: Families Added Through Addendums

Region	Community	Families on Original List	Families Later Added through Addendums	Percentage of Families Added by Addendums vs. original number of families
Aguaytia	Boqueron	132	315	239%
	Huacamayo	58	248	428%
	Idayacu	75	319	425%
	Libertad	99	304	307%
	Los Olivos	39	283	726%
San Martin	Nueva Esperanza	5	78	1,560%
	Paltaico	18	83	461%
	San Juan de Talliquihui	24	85	354%
Tingo Maria	La Banda de Chazuta	172	436	253%
	Peregrinos	79	90	114%
Tocache	Sector J. Carlos Maria	51	113	222%
	Alto Afilador	86	100	116%
	Alto Progreso	89	97	109%
	Ciruelo	26	67	258%
	La Florida	35	112	320%

Region	Community	Families on Original List	Families Later Added through Addendums	Percentage of Families Added by Addendums vs. original number of families
	Rio Blanco	42	110	262%
	Sitully	99	137	138%
	Tupac Amaru	40	64	160%
	Almendres	23	53	230%
Ucayali	28 de Julio	43	123	286%
	Nueva Dinamarca	33	50	152%
	Manco Copac	11	60	545%
	Shringal Bajo	36	101	281%
	Vista Alegre de Chia	30	121	403%

In addition, the mission acknowledged the importance of these issues in its evaluation of the contractor's performance when it stated, "Chemonics should have done a better job in...controlling the number of heads of households who received the payment to eradicate their coca—problems arose when more than one person in a family was allowed to claim the payment."

The main reason why community lists were inflated was that Chemonics did not have sufficient controls in place to ensure that only legitimate heads of households were included on the lists and USAID/Peru did not have sufficient procedures in place to verify the legitimacy of beneficiary names on the community lists. Also, many of the communities lacked clearly defined borders, and the absence of land titles made it difficult to verify who owned land in each community. In some cases, Chemonics employees reportedly encouraged community members to inflate the lists so that they (the Chemonics employees) could meet program performance targets. Finally, Chemonics, with USAID/Peru's knowledge and support, did not adhere to the provision of the community agreements that prohibited changes to the lists of heads of households. Chemonics and USAID/Peru staff members were willing to overlook this agreement provision so that community members who decided to join the program at a later date could be added to the lists and receive cash payments.

As a result of these practices and other anomalies, questionable payments were made under the program. Ineligible payments are listed in Table 2 below.

Table 2: Ineligible Cash Payments – 2003 to 2007

Payments made on the basis of fictitious names, minor children, or people from outside 13 communities in the Ucayali region	\$300,181 ²
Difference between the number of individuals receiving cash payments under the program (64,891) and the number of individuals included in lists of heads of households (63,773)	\$160,346 ³
Double payments to 45 individuals in the Aguaytia region	\$8,100

² This total was calculated using data from the local audit firm regarding the percentage of ineligible beneficiaries times the total amount of cash payments made in each of the 13 communities.

³ This figure was calculated using data provided by USAID/Peru and Chemonics as $[(64,891 - 63,773) / 64,891] \times \text{total cash payments of } \$9,306,861 \text{ during } 2003 \text{ to } 2007.$

Payments to 52 individuals in the Aguaytia and Tocache regions who were not recognized as community members	\$9,360
Payments to individuals added to lists of heads of households in violation of the community agreement provision prohibiting modification of the original lists	\$2,458,152 ⁴
Total Ineligible Cash Payments Questioned	\$2,936,139

In addition, the mission and Chemonics overstated results of the program, which also led to paying more to Chemonics in performance award fees than necessary. (See finding on page 18.)

Recommendation No. 1: We recommend that USAID/Peru arrange for an agency-contracted audit to purge fictitious names and ineligible individuals from the lists of heads of households for the entire Alternative Development Program.

Recommendation No. 2: We recommend that USAID/Peru end the practice of adding names to community lists in violation of the community agreements.

Recommendation No. 3: We recommend that USAID/Peru ensure that Chemonics International, Inc. has implemented controls to reasonably ensure that cash payments are only made to eligible heads of households in assisted communities.

Recommendation No. 4: We recommend that USAID/Peru establish procedures to periodically validate the accuracy of the lists of heads of households.

Recommendation No. 5: We recommend that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$2,936,139 and recover from Chemonics International, Inc., the amounts determined to be unallowable.

Evaluation of Management Comments – In response to our draft report, USAID/Peru stated that it concurred with Recommendation Nos. 1 through 5.

Regarding Recommendation No. 1, the mission stated that it would contract a limited-scope financial review to review cash payments under the program. USAID/Peru noted that, based on its review of cash payments, it reached the same conclusion as our audit that the contractor's internal control procedures for the cash payments were deficient.

In response to Recommendation No. 2, USAID/Peru stated that it does not foresee any further modifications of the over 800 voluntary eradication agreements already signed and so there will be no need to add or subtract names from the community lists.

In response to Recommendation Nos. 3 and 4, USAID/Peru noted that because the program has discontinued voluntary eradication as an implementation mode, the payment of cash bonuses for voluntary eradication has also ended. However, cash payments will continue, but only in the framework of temporary work carried out in the post eradication interventions called for under a new contract. USAID/Peru specified the controls that the contractor has instituted under the new contract to ensure that cash

⁴ Calculated as $[(18,115 / 63,773) \times \$9,306,861] - \$185,503$. (This last amount represents the portion of the \$300,181 in questioned costs that pertain to addendums already included in the table for the 13 communities. We have deducted the amount to avoid double counting these costs.)

payments are only made to eligible signers of memoranda of understanding, as well as procedures to periodically validate the accuracy of the lists of heads of household.

Regarding Recommendation No. 5, USAID/Peru stated that mission staff have met several times with the contractor to determine if the contractor had records to support the exact amount of bonuses paid under addendas. Unfortunately, the contractor was unable to produce a reliable, auditable calculation of the amount actually paid. As mentioned under Recommendation No. 1, USAID/Peru will contract directly for a financial review to analyze data produced from the contractor’s tracking system and this financial review will lead the mission to a more accurate determination.

Based on the information provided by USAID/Peru, we consider that final action has been taken on Recommendation Nos. 2, 3, and 4. A management decision for Recommendation No. 1 can be reached when USAID/Peru provides timeframes to complete the contracted financial review. A management decision for Recommendation No. 5 can be reached when USAID/Peru makes a final determination of the amount of ineligible questioned costs to be sustained.

Did USAID/Peru’s Alternative Development Program activities achieve current performance targets and what has been the impact?

The program is meeting performance targets for voluntary eradication of coca and substantially met an FY 2006 target for the percentage of families in program areas that believe coca should be eliminated from their communities. The Alternative Development Program’s performance with respect to other important performance targets is unclear because of evidence that lists of beneficiary heads of households have been inflated (see the related finding on page 12). The following table shows the available information on planned, reported, and actual results for fiscal years 2006 and 2007.

Table 3: Planned, Reported, and Actual Results

Main Indicators	FY 2006			FY 2007		
	Target	Reported	Actual	Target	Reported	Actual
Number of hectares of illicit coca voluntarily eradicated in ADP target areas ⁵	2,500	4,348	4,348	2,500	2,052	2,052
Percentage of families in program areas that believe coca should be eliminated from their communities	47.5	46	46	N/A	N/A	N/A

⁵ Chemonics’ monitoring and evaluation database shows that 1,383 hectares in FY 2006 and 1,718 hectares in FY 2007 that were reported eradicated were declared by communities after the original community agreements were signed and were added through addendums—a practice prohibited by the agreements themselves but accepted by the program. As is discussed in the finding beginning on page 12, there is evidence that some of the addendums had a fraudulent purpose.

Main Indicators	FY 2006			FY 2007		
	Target	Reported	Actual	Target	Reported	Actual
Number of families that agree to eliminate their coca (cumulative)	43,800	53,515	Unknown	68,000	63,491	Unknown
Number of program client families who remain coca free (cumulative)	38,000	39,811	Unknown	N/A	N/A	N/A

The mission reported successful achievement of the annual targets for the other two indicators (number of families that agree to eliminate their coca and the number of families that remain coca free) for 2006 reporting 53,515 and 39,811 families, respectively. In addition, the mission reported that 63,491 families agreed to eliminate their coca in 2007 (the mission discontinued the indicator on number of families that remain coca free). However, as stated previously, these indicators are based on community family lists, which were found to be greatly overstated in 13 communities in one region. Community lists were also found to be overstated in other regions, although no detailed review has yet been undertaken to purge the fictitious and ineligible names from the lists.

Regarding the impact of the program, one of the key objectives of the Alternative Development Program (ADP) is to change public attitudes toward coca in Peru. Coca is legal in Peru, but it is estimated that only 6 to 7 percent of the coca grown is used for legal purposes; the remaining amount is grown and sold into the illegal drug economy. To address this problem and to strengthen the sustainability of the program, the ADP has included a communications strategy to inform Peruvians about the dangers and negative consequences of illegal coca. The communications strategy is intended to change public opinion regarding the cultivation of coca, a practice which can create a narcoeconomy in certain regions of the country. In addition to showing citizens in the program's target areas that they can earn a livelihood from crops other than coca, the program has a communication "outreach" component that includes national radio spots focusing on the dangers of coca crops and damage to the country, a woman-led radio talk show, an environmental program discussing and showing the damage that can be done to the land as a result of coca crops, 15-minute news programs covering different aspects of the Alternative Development Program, and a 10-episode miniseries that shows the negative effects of coca on the families who grow, sell, and consume it. To measure the program's success at changing public opinion regarding coca, the mission included as a performance indicator "the percentage of families in program areas that believe coca should be eliminated from their communities" to measure the changes in beliefs and attitudes toward coca as a result of the program's efforts. Over the course of the Alternative Development Program, public perceptions of coca eradication have increased for the better; in 2006, 46 percent of the target population believed that coca should be eliminated, up from 43 percent in 2003.

The Alternative Development Program had other, more direct positive impacts on many Peruvians' lives. Many of the program's beneficiaries in small rural communities commented that since they have eliminated coca growing there is no market for coca leaves and narcotraffickers no longer come to their communities. As a result, their communities have experienced less crime, less alcohol consumption, less violence, and a general return to a peaceful community and more tranquil lives.

The following section discusses the overstatement of certain program results.

Some Program Results Were Overstated

Summary: Three of the four main performance indicators for the Alternative Development Program are “the number of hectares of illicit coca voluntarily eradicated”, “the number of families that remain coca free”, and “the number of families that agree to eliminate their coca.” Performance results for these indicators were overstated. For example, more than 18,000 families have been added to the community member lists and more than 3,400 hectares of coca has been reported as eradicated as a result of the use of addendums to the original agreements with communities, a practice that is prohibited by the community agreements themselves. In addition, a local audit firm that reviewed beneficiary rolls in 13 communities reported that lists of heads of households were inflated and that addendums were used to fraudulently obtain cash payments from the program (see page 12). The overstatement of performance results occurred because neither USAID/Peru nor Chemonics had sufficient controls in place to ensure that results were accurately reported. As a result of the overstatements, stakeholders do not know the true results achieved by the program and USAID/Peru paid excess performance award fees to Chemonics.

Three of the four main performance indicators for the Alternative Development Program are the number of hectares of illicit coca voluntarily eradicated, the number of families that remain coca free, and the number of families that agree to eliminate their coca. Chemonics and USAID/Peru periodically report on these performance indicators so that stakeholders will be aware of the program’s progress in achieving planned results.

However, the reported results were overstated due to the use of addendums. Many of the addendums—and at least some of the original beneficiary lists included in original community agreements—included fictitious names, minor children, and people from outside the community. Without a thorough verification of the individuals and coca plots reported under the program, the extent to which results are overstated cannot be known. However, the following points help indicate the possible extent of the issue:

- Mission and Chemonics data show that a total of 53,515 families agreed to eliminate their coca since the beginning of the program in 2002 through the end of FY 2006, and 63,491 families agreed to eliminate their coca through the end of FY 2007. If these results were reduced to eliminate names added through addendums, a practice prohibited by the community agreements, then 41,055 families would have been reported in FY 2006 and 45,658 families would have been reported in FY 2007, both less than the targets for those years. (See Table 3 on page 16.) Also, a local audit firm reviewed beneficiary rolls in 13 communities and estimated that, for 12 of the communities, 78 percent of the names were spurious. We have not projected this result to the entire population of families reported, but obviously overstatements in original community lists would distort reported results.
- The performance indicator for the number of families that remain coca free is based on the number of client families in the program less those that currently maintain coca plots. The number of families that currently maintain coca plots is based on client self-reporting through surveys by DEVIDA. The need for thousands of addendums to add parcels of coca that were previously not reported by communities calls into question the reliability of this self-reporting process.
- The mission and Chemonics reported that 4,348 hectares of coca were voluntarily eradicated in FY 2006 and that 2,052 hectares were voluntarily eradicated in FY

2007. For FY 2006 and FY 2007, the number of hectares added through addendums represents 32 percent and 84 percent, respectively, of the total hectares reportedly eradicated under the program. Reducing these reported results to eliminate the prohibited practice of adding coca plots through addendums and then reporting them as eradicated would result in 2,965 hectares voluntarily eradicated in FY 2006 and 334 hectares voluntarily eradicated in FY 2007. (Please refer to Table 3 on page 16.)

These problems occurred because neither USAID/Peru nor Chemonics had sufficient controls in place to ensure that results were accurately reported. Also, the mission and Chemonics did not adhere to the program's own policy by prohibiting addendums. Finally, an audit firm that reviewed beneficiary lists in 13 communities reported that some Chemonics staff promoted these schemes to meet program performance targets.

As a result, the mission and Chemonics overstated program results. Overstated results could lead USAID/Washington and other stakeholders to reach incorrect conclusions about the effectiveness of the program. In addition, community members and other individuals not belonging to the community benefited from these questionable practices (which included subdividing coca parcels and not declaring all coca up-front in order to receive inappropriate payments).

We believe that these irregular practices and the subsequent overstatement of results also led to Chemonics receiving performance award fees that were unearned. So far, Chemonics has received \$3.6 million of the possible \$5.1 million in award fees over the life of the current contract.

In June 2007, Chemonics was awarded \$1.51 million out of \$1.73 million that was available for contract performance period April 1, 2006, through March 31, 2007. Of the \$1.51 million award fee, \$742,049 was based on the achievement of performance targets for the indicators "number of hectares voluntarily eradicated" and "the number of families that agree to eliminate their coca."⁶ The new award fee plan for this contract "weighted" a portion of the overall total possible award fee to the contractor achieving the annual targets for "the number of hectares voluntarily eradicated" and "the number of families that agree to eradicate their coca." As a result, a sizable portion of the award fee received by Chemonics was based on achieving these two targets—both of which were overstated by Chemonics. The mission acknowledged these same issues in its award fee determination document for the performance period, stating the following in its evaluation section on performance weaknesses:

[The] teams in the field 'grew into' a system in which communities were allowed to be included in the VE [voluntary eradication] program, even though there was 'coca non declarada' (CND) known to exist within the community. Such was the amount of CND that it comprised 51% of the coca eradicated in 2006. [T]here are still concerns about the density of the coca eradicated and the fact that a large part of it comes from addendas. Finally, Chemonics should have done a better job in...controlling the number of heads of households who received the

⁶ To achieve the required results for the indicator "the number of families that agree to eliminate their coca", the contractor is responsible for designing, implementing, overseeing, and reporting on a social marketing program focused on communications for behavior change, where (1) there is recognition and ownership that illicit coca and its link to narcotics trafficking are a major impediment to development, and (2) there is a desire by local audiences to participate in ADP activities.

payment to eradicate their coca – problems arose when more than one person in a family was allowed to claim the payment.

Table 4 on the following page illustrates the amount of award fees earned by the contractor through September 2007. It includes a breakout of the estimated portion of the award fee earned during each performance period that is attributed to achieving the (overstated) indicator targets.

Table 4: Award Fee Amounts Paid for Achieving Indicator Targets

Performance Period	Total Award Fee Paid ⁷	Estimated Amount Paid For Achievement Of Performance Targets ⁸
3/17/04 – 3/31/05	\$783,230	\$287,185
4/1/05 – 3/31/06	\$1,351,483	\$366,179
4/1/06 – 3/31/07	\$1,506,849	\$742,049
	\$3,641,562	\$1,395,413

RIG/San Salvador believes that the performance award fee given to Chemonics was inappropriate because a portion of the fee was based on the incorrectly reported program indicators “number of hectares voluntarily eradicated” and “number of families who agree to voluntarily eradicate their coca” (see page 12). The irregular methods used by some contractor staff to increase the number of names on the community list resulted in an overstatement of performance results achieved and ultimately resulted in the awarding of performance fees that were unearned.

Recommendation No. 6: We recommend that USAID/Peru revise reported results on number of families that agree to eliminate their coca and the number of families who remain coca free, based on the completion of actions taken in response to Recommendation No. 1 on page 15.

Recommendation No. 7: We recommend that USAID/Peru review the award fee paid to Chemonics International, Inc. and make a management decision with regard to the ineligible questioned costs of \$1,395,413 in award fees paid for achievement of performance targets.

Recommendation No. 8: We recommend that USAID/Peru establish procedures to periodically validate the results reported by Chemonics International, Inc.

Evaluation of Management Comments – In response to the draft report, USAID/Peru said that it did not fully concur with Recommendation No. 6 and stated that revising these reported results would entail a complex methodology that would require field visits to each of the 800 communities to interview current residents of the community on the

⁷ The award fee paid is not necessarily the total award fee available for each performance period. The amount of the award fee to be paid is determined by the Fee Determination Official and is based on an evaluation of the contractor’s performance for the period by a Performance Evaluation Board.

⁸ This amount was calculated using the evaluation criterion percentages for the Technical Achievement portion of the award fee related to achieving targets for the “number of hectares voluntarily eradicated” and for the “number of families that sign participation agreements and voluntarily eradicate their coca.” These weighted percentages changed in 2006 following a recommendation in the previous audit.

accuracy of a list that was used by the program. The mission stated that the cost of the study, including trying to track down beneficiaries who no longer lived in the community, would be extremely cost prohibitive.

We believe that the mission misunderstood the actions called for in Recommendation No. 6. The recommendation does not call for the mission to perform work at all 800 communities, including trying to track down beneficiaries who no longer lived in the community. Rather, the intent of the recommendation is for the mission to revise reported results based on the results of the contracted financial review. The contracted financial review will determine, on a sample basis, cash payments made based on fictitious names, names of minors, and names of people not residing in the community. The recommended action is for the mission to then adjust the reported results on number of families in the communities by removing these ineligible names discovered from the financial review. Because the award fee was based in part on the number of families reported, the action taken on this recommendation will be necessary for the mission to complete action on Recommendation No. 7.

USAID/Peru concurred with Recommendation No. 7, and believes that the financial review cited in the response to Recommendation No. 1 will provide the necessary information to review the award fee. Based on the outcome of the full review and final determination of Chemonics' liability (once the Bill for Collection amount is determined and fully settled to USAID's satisfaction) a second Bill for Collection for the related and appropriate amount for an award fee adjustment will be issued to recover excess funds paid, if any.

USAID/Peru agreed with Recommendation No. 8 and stated that, over the past two years, the mission has strengthened processes for validation of results achieved by the contractor. As part of joint activities, teams visited more than 300 communities during 2007 to perform field verifications. In addition, the monitoring and evaluation committee is implementing further steps to validate results reported directly by the contractor for the new contract. Beginning in 2008, the field verifications will include analysis of specific results reported by the contractor in its quarterly reports throughout the year. In addition, the mission will send a financial analyst to the field offices to spot check inputs, reports, and findings.

Based on the information provided by USAID/Peru, we consider that final action has been taken on Recommendation No. 8. A management decision for Recommendation No. 6 can be reached when USAID/Peru and RIG/San Salvador agree on the actions to be taken, including the timeframes to complete the actions. A management decision for Recommendation No. 7 can be reached when USAID/Peru makes a final determination of the amount of excess award fees to be recovered.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/San Salvador conducted this audit in accordance with generally accepted government auditing standards. Fieldwork for this audit was performed in Peru from October 1 to October 24, 2007, at USAID/Peru, Chemonics International, Inc., various contractor regional offices, governmental offices, and selected program communities.

As part of its fiscal year 2008 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions: (1) Were the actions taken by USAID/Peru in response to recommendations in Audit Report No. 1-527-06-001-P effective? (2) Did USAID/Peru's Alternative Development Program activities achieve current performance targets and what has been the impact?

In planning and performing the audit, we reviewed and assessed the effectiveness of USAID/Peru management controls related to the Alternative Development Program. The significant USAID/Peru controls identified included preparing a performance monitoring plan, reviewing contractor performance and financial reports, conducting site visits, and maintaining regular contact with the contractor. Chemonics hired a local auditing firm to review suspected improper practices that may have resulted in ineligible names being included on community (beneficiary) lists in the Ucayali region. To develop a basis for relying on the firm's work, we met with the firm's staff and reviewed their methodology.

Out of a total 802 communities, we judgmentally selected 19 communities in the San Martin and Ucayali regions to conduct site visits. We focused our selection on communities that had various numbers of community members, various types of infrastructure projects, and various types of licit crop projects. We determined that a judgmental sample was reasonable because of the nature of the conditions in the field, the distance from one community to the other, and security concerns. We were unable to conduct site visits in the other parts of the regions because of security concerns and travel time and distances. In these 19 communities, we observed examples of infrastructure and licit crop projects and discussed the program with various community leaders and program beneficiaries.

The audit primarily covered the community support activities managed primarily through Chemonics International, Inc. and covered FY 2006 and FY 2007. The contract was signed in March 2004 for \$102 million for 4 years (from March 2004 through September 2007 and extended through March 2008) for a total estimated contract cost of \$116.5 million. As of September 30, 2007, approximately \$106.4 million had been obligated with disbursements of \$31 million and \$29 million in FY 2006 and 2007 respectively. Interviews were conducted with mission officials, Chemonics, Government of Peru officials, State Department officials, United Nations officials, and program beneficiaries. We also examined program documentation provided by these parties.

Methodology

To answer the first question described in the scope section, we made a determination as to the effectiveness of the mission's actions to address each of the 16 recommendations in the above referenced audit report. To make the determinations, we analyzed the

mission's written responses on how they would or have addressed each recommendation in the prior audit report, interviewed mission and Chemonics staff, reviewed documentation that supported that effective implementation and action had been taken, and verified whether any new procedures or policies were applied as a result of the recommendations. In addition, we reviewed the current staffing plan for Chemonics to determine the current staffing needs.

To answer the second question described in the scope section above, we traced actual results reported by Chemonics, to supporting documentation generated from the monitoring and evaluation database developed by Chemonics. We reviewed infrastructure and productive projects during the site visits at the communities mentioned in the scope section. In addition, we reviewed USAID/Peru's performance monitoring plan, USAID/Peru's 2006 annual report, the contracts between USAID/Peru and Chemonics, Chemonics' annual reports, Chemonics' progress reports, the monitoring and evaluation system developed by Chemonics, and the award fee plan prepared by the mission. Based on the performance indicator documents, mission portfolio review documents, and the contract agreement and award fee plan between USAID/Peru and Chemonics, we selected the four main indicators of the program to determine if the planned results were being achieved. We interviewed the Alternative Development Program director, cognizant technical officer, contracting officer, monitoring and evaluation specialist, and other Alternative Development Program team members. We also interviewed officials from Chemonics, DEVIDA (*Comisión Nacional para el Desarrollo y Vida Sin Drogas* – Government of Peru's counternarcotics agency), CADA (*Cuerpo de Asistencia para el Desarrollo Alternativo* – Government of Peru entity that measures the coca area before and after eradication), NAS (State Department's Narcotics Affairs Section), and beneficiaries in the selected communities.

We also held discussions with the U.S. Ambassador to Peru, United Nations officials, and staff of the local auditing firm that reviewed the community lists in the Ucayali region.

In answering the audit questions (audit objectives), we considered exceptions totaling 5 percent or more of the cases tested to represent significant issues meriting reporting.

MANAGEMENT COMMENTS

MEMORANDUM

Date: March 3, 2008

To: Timothy Cox, Regional Inspector General/San Salvador

From: Paul Weisenfeld, USAID/Peru Mission Director
Erin McKee, Supervisory Regional Contracting Officer

Subject: Follow-Up Audit of USAID/Peru's Alternative Development Program

Thank you for giving USAID/Peru the opportunity to respond to a draft of the follow-up audit of the Alternative Development Program (ADP). Below is the Mission's initial response to the eight recommendations outlined in the draft audit. Following the responses to the recommendations are USAID/Peru's comments and suggestions on the draft audit report for your consideration (see Annex).

We would also like to thank your team, for spending time in Peru in the office and in the field evaluating the impact that ADP is having on its target population. Your efforts are helping us to refine our program and improve impact where it matters – in some of the poorest areas of Peru. We look forward to a timely resolution of the eight recommendations. Having said this, it is unfortunate that the RIG devotes such a small space to the programmatic successes of the alternative development program. While USAID/Peru recognizes some implementation problems, (which are to be expected in a complicated program being implemented in isolated regions operating under pressure from violent, organized criminal elements), and limited mishandling of cash payments, there is much to celebrate in the changes that are occurring in former coca-growing regions.

Recommendations

1. "We recommend that USAID/Peru arrange for an agency-contracted audit to purge fictitious names and ineligible individuals from the lists of heads of household."

USAID/Peru concurs with this recommendation. We note, however, that the engagement would not be considered an audit but a limited-scope financial review, without a formal audit opinion on the Fund Accountability Statement.

The Mission's own financial review of the payment of bonuses under the Voluntary Eradication Program bring us to the same conclusion: that the contractor's internal control procedures for the payment of bonuses and wages through the regional offices were deficient. Chemonics' Office of Finance and Administration did not participate in the supervision of these payments. As a result of weak controls, several irregularities occurred, including: 1) payments to individuals under fictitious names, 2) duplicate payments to eligible recipients, 3) payments to ineligible minors, and 4) payments to people not on the community list and not eligible for this benefit. Furthermore, while

payments made to beneficiaries under the original agreements followed procedures established in the “Facilitator’s Manual”, approved by USAID to certify eligibility of the beneficiaries, payments under the addenda did not follow these control procedures.

2. “We recommend that USAID/Peru end the practice of adding names to community lists in violation of the community agreements.”

USAID/Peru agrees with this recommendation.

Under the audited program, we do not foresee any further modifications of the over 800 voluntary eradication agreements already signed and so there will be no need to add or subtract names from the community lists linked to those 800 community agreements.

Future agreements with post-programmed eradication communities will continue to be between the GoP and the community. Given the general environment where the program is implemented - characterized by an immediate out-migration after eradication counterbalanced by a constant flow of in-migration, unclear community boundaries and undocumented members of communities - community lists are in a constant state of flux. Because of this fluctuation, and to keep the community lists as accurate as possible, names must be added and subtracted as appropriate as a basic element of the implementation process. Chemonics will work with the local authorities, the communities themselves and other actors in the area to make sure that the lists are as accurate as possible. The post-eradication community agreements do not have a clause that prohibits the parties from amending the agreements and this will continue to be the case. New communities that will be added to the program will take place under the post coca eradication methodology, which calls for signing initial agreements with groups of families, followed by an expansion of the agreements to incorporate new families as they decide to enter the program. This methodology has proven to be highly effective in the Tocache post-eradication program. Under the new contract little or no voluntary eradication is contemplated.

3. “We recommend that USAID/Peru ensure that Chemonics has implemented controls to reasonably ensure that cash payments are only made to eligible heads of household in assisted communities.”

USAID/Peru agrees with this recommendation and proposes the following:

Given that the alternative development program has discontinued voluntary eradication as an implementation mode, the payment of cash bonuses for voluntary eradication has also ended. However, cash payments will continue, but only in the framework of temporary work carried out in the post eradication interventions called for under the new Promoting Integrated Development contract. Cash payments are only made to signers of memoranda of understanding (*actas de entendimiento*) for work performed primarily to improve the productive capacity of their family farms. Temporary work is supervised by program staff and paid after work is completed. In most cases temporary work is paid for no more than 20 days at an average daily wage of approximately five dollars. When work is completed, regional office program staff enters the roster of persons to be paid in the data base, which is accessed by Lima-based financial control staff who reviews the roster and advance funds to the regional office for payment. A bonded Chemonics employee specializing in cash payments withdraws the funds and transports these funds in cash with police escort to the community for payment to the registered beneficiary, who must identify him or herself. At no time is more than \$10,000 transported to comply with insurance provisions. No payments are authorized to third parties or the use of

powers of attorney. As voluntary eradication is not contemplated under the new contract, no future bonus payments will be made.

4. “We recommend that USAID/Peru establish procedures to periodically validate the accuracy of the lists of heads of household.”

USAID/Peru agrees with this recommendation.

Under the audited program, there are three mechanisms for validating and updating lists of heads of households who receive program benefits, primarily for crop implementation, technical assistance, training, or other productive activities. These mechanisms are reliable in validating the non-transitory program beneficiaries - those beneficiaries who remain in the community after coca is eradicated. The first mechanism pertains to the periodic modifications of grant agreements and sub-contracts. Each time a modification is made, field staff verify the continued presence of each beneficiary in the program, in addition to incorporating new beneficiaries that might result from recently signed framework agreements or addenda. The list of beneficiaries is altered by some deletions of persons who migrate, or addition of new beneficiaries as mentioned earlier. The new rosters are incorporated into the program database. The second manner for validating rosters is derived from the monthly technical reports from contractor or grantee field staff, corroborated and entered into the database by program technical staff. This ensures that lists of beneficiaries also remain continually updated. The third mechanism is performed by the field-based monitoring and evaluation staff who visit each beneficiary community to ascertain that the program has accurate and updated lists, and that these correspond to persons receiving program benefits. These three mechanisms continuously validate those beneficiaries who receive technical assistance or training. They do not keep current those beneficiaries who just received a bonus or a project that benefited the whole community, such as a school.

5. “We recommended that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$2,936,139 and recover from Chemonics International Inc., the amounts determined to be unallowable.”

USAID/Peru concurs with this recommendation. Mission staff have met several times with the contractor to determine if the contractor had records to support the exact amount of bonuses paid under addenda. Unfortunately, Chemonics was unable to produce a reliable, auditable calculation of the amount actually paid. Chemonics' database does not distinguish between cash paid to beneficiaries in framework agreements and cash paid to them in addenda. Mission management met with the Chemonics country director to discuss appropriate next steps. As a result of this meeting, Chemonics is in the process of reviewing all agreements and addenda and flagging respective payments to these two categories in the database. The next step will be a careful comparison of paper records of individual payments with the data recorded in their tracking system. Chemonics estimates this can be completed within 60 days and will result in an auditable trail of payments. USAID/Peru will contract directly for the financial review to analyze the data produced by the Chemonics tracking system, based on the completion of the above steps. USAID/Peru is confident that, by taking the above steps, good and accurate information will be available for the USAID's financial review. The recommended agency-contracted financial review will lead us to a more accurate determination.

The Mission feels that one clarification is needed. USAID/Peru was fully aware of the addenda, approved them and communicated the approval to our contractor. The CTO

and every other USAID employee involved in this Program have stated unequivocally that they had full knowledge of the “addenda” process and had agreed on this process in numerous meetings with Chemonics and DEVIDA. USAID/Peru considers that the real problem was Chemonics’ lack of adequate internal controls in the execution of these addenda, mostly in the early days of the activity. According to Chemonics, bonus payments were administered by a “Monitoring and Evaluation” office and, for the first two years, were made in cash. Two years into the program, this office began implementation of better controls and monitoring. Unfortunately, their monitoring system was unable to produce a reliable account of payments under addenda. Finally, because the contractor’s Office of Finance and Administration posted these payments under one line, Chemonics is also unable to use its accounting system to segregate payments made under the original agreements and those made under the addenda. As described above, we have worked out a plan to address this issue.

6. “We recommend that USAID/Peru revise reported results on number of families that agree to eliminate their coca, and the number of families that remain coca free based on the completion of actions taken in response to Recommendation No. 1.”

USAID/Peru does not fully concur with this recommendation. Revising these reported results would entail a complex methodology that would require field visits to each of the 800 communities to interview current residents of the community on the accuracy of a list that was used by the program. As stated previously, there is a high instance of migration in these communities and the reliability of first-hand accounts of who made up the community at the time of the signing of the agreement would be subject to a myriad of factors – so many, in fact, that any conclusions would be undependable. The cost of this study, including trying to track down beneficiaries who no longer lived in the community, to ascertain their status at the time of the signing, would be extremely cost prohibitive. The cost/benefit of such an extensive, and at this stage somewhat artificial, reconstruction of results does not serve what USAID/Peru understands to be the intent of this recommendation.

7. “We recommend that USAID/Peru review the award fee paid to Chemonics and make a management decision with regard to the ineligible questioned costs of \$1,395,413 in award fees paid for achievement of performance targets.”

USAID/Peru concurs with this finding, but believes that the financial review cited in the response to recommendation #1 will provide the information necessary to review the award fee. Based on the outcome of the full review and final determination of Chemonics’ liability (once the Bill for Collection amount is determined and fully settled to USAID’s satisfaction) a secondary Bill for Collection for the related and appropriate amount for an award fee adjustment will be issued to recover excess funds paid, if any.

8. “We recommend that USAID/Peru establish procedures to periodically validate the results reported by Chemonics.”

USAID/Peru agrees with this recommendation. In fact, over the past two years, the Mission has implemented strengthened processes for validation of results achieved by Chemonics, and to provide timely, objective information for decision-making and implementation. Additionally, it merits stating that it was the M&E system that flagged many of the issues that arose in the course of the programmatic audit.

With respect to M&E, the Mission practices joint monitoring activities involving USAID, Chemonics, and DEVIDA. A Monitoring and Evaluation committee meets frequently to plan and execute joint activities to objectively measure program achievements and report on program results. As a result of this framework, M&E activities in Pucallpa successfully identified and informed management about irregularities in program implementation in Pucallpa, which the audit report recognizes in its findings.

As part of the joint activities, there are continuous field verifications of results reported by Chemonics. Teams lead by DEVIDA M&E specialists visited more than 300 communities during 2007 alone to verify results and reported achievements. The exhaustive community-based reports resulting from those field verifications were presented to Chemonics, DEVIDA, and USAID management for decision-making and follow-up. The joint M&E committee also regularly reviews the information management system managed by Chemonics to evaluate how data input into the system is validated, and makes suggestions to improve controls and quality of information and reporting.

In addition to ongoing activities and strategies, the M&E committee is implementing further steps to validate results reported directly by Chemonics for the new contract. Beginning in 2008, the field verifications/surveys implemented by DEVIDA will also include analysis of specific results reported by Chemonics in their quarterly reports through the year. For any key results not suitable for verification through the instruments used in the verifications, USAID program staff will randomly select from among those key results in the quarterly report and will validate them in the field. The results from these quarterly assessments will be reported to the CTO.

In addition, USAID will send the USAID/Peru financial analyst to the field offices to spot check M&E inputs, reports and findings. This will be carried out on a biannual basis.

Comments on Draft Audit Report:

Page 1 paragraph 1: The USG CN strategy is founded on three pillars – 1) Interdiction (which is law enforcement); 2) Eradication and 3) Alternative Development.

Page 1, paragraph 6: As the program matured, USAID and Chemonics realized that 100 percent of the communities' coca was not being declared. Rather than halt the successful inroads that had been made in the area, the decision was made to incorporate the concept of "coca no declarada" (undeclared coca) as a necessary component of the program. The other option would have been to cease all activity in the community and allow the space for narco-traffickers to move back in and reverse the progress that had been made with the majority of the population. Judging from the success achieved in coca eradication, it appears that this strategy worked in most of the geographical areas with the net effect that people, who were reluctant to join the program, once they saw that the ADP was viable, declared their coca and eradicated it. This represents a significant lesson learned and achievement of the PDA program. The requirement in the initial design for up-front voluntary eradication as a condition for receiving program support was an innovative feature that, with appropriate adjustments reflecting implementation experience, proved to be feasible.

Page 1, paragraph 7: There is no evidence of widespread fraudulent and ineligible payments. There is evidence, however, identified and reported by Chemonics, that in a limited geographical area, Chemonics employees encouraged farmers to sub-divide their land among friends and relatives in order to receive a higher cash bonus, increasing their incentive to join the program and eradicate their coca. From all accounts, the practice was encouraged, not for personal gain by the Chemonics employees, but to reach the eradication target.

Page 1, paragraph 8: USAID and its contractor faithfully monitored and enforced to the extent possible the \$2,000 per hectare limit. In RIG's analysis fiscal year 2006 is used as the time period, which would include the last quarter of CY05. The 2005 audit recommendations had not been published during the last quarter of CY05, nor had the management decision been made and approved. In an analysis of the contract's calendar years 2006 and 2007 plans, there was an investment in excess of \$2,000 per hectare in 27 percent of the communities. This is off-set, though, by lower investments in other communities. The average investment per hectare eradicated in 2006 was \$1,913.51 and in 2007 it was \$789.53. The pertinent programmatic question now is whether this investment supports sustainable eradication. (Please see the attached spreadsheets for Investment per hectare for Plans 2006 and 2007.)

Page 2, paragraph 2: The RIG states that the program "...substantially met a fiscal year target for the percentage of families in program areas that believe coca should be eliminated from their communities." In fact, the program met this target in 2006. You might say that the program consistently met this target. The RIG inaccurately portrays this fact by using the "substantial" qualifier.

Page 2, paragraph 2: We request that the RIG removes the word "substantially" when describing inflated community heads of household lists. Whether the practice was substantial or not will only be proven once the financial review is concluded.

Page 3, paragraph 1: replace “native population” with “highland population”.

Page 3, paragraph 1: As stated above: “The USG CN strategy is founded on three pillars – 1) Interdiction (which is law enforcement); 2) Eradication and 3) Alternative Development.

Page 4, paragraph 3: For the measuring and validation of eradication of coca, CADA is funded by USAID, not NAS.

Page 7, paragraph 1: Change “contends” to “argues”.

Page 7, paragraph 2: The RIG claims that USAID/Peru and Chemonics informally tolerated small-scale coca cultivation in PDA communities. While USAID/Peru did not, formally acknowledge the fact that many communities neglected to declare all of their coca, thus, forcing the program to develop a methodology for eradicating this non-declared coca, USAID/Peru was aware that Chemonics was amending community agreements to capture this coca and get it eradicated. What USAID did criticize in its award fee statement (referred to on page 18) was that the contractor signed up communities knowing that there was coca “no declarada” that would have to be addressed later due to the reluctance and hostility of some community members or coca owners to submit to voluntary eradication. Despite this criticism, the contractor did, indeed, reach its eradication target and the number of families willing to eradicate their coca.

Page 8, paragraph 6: Please add before the sentence “Chemonics subsequently hired an audit firm to review the cash payments...”, “Internal controls of Chemonics, through the monitoring and evaluation team, detected irregularities in a specific geographic region.”

Page 9, paragraph 7: The RIG’s parenthesized comment that the program had invested \$1.6 million in 24 communities that ultimately rejected the program and decided not to eradicate their coca should be taken out of the report, as this issue was addressed satisfactorily in the first RIG audit. Moreover, this comment does not adequately put a very complex situation in proper context and fails to recognize that USAID/Peru was the first and only mission to implement a program of voluntary eradication and to condition development investments on that eradication.

Page 11, paragraph 5: The mission disagrees with the overall tone of the draft audit report when discussing the issue of the amendments to the community agreements, and specifically requests that this “Summary” section and the additional background on page 12 be significantly rewritten to reflect the facts. Through the use of words such as “scheme” and the characterization of benefit payments under the amendments as “improper”, the draft report implies that somehow it was a mistake (or worse, somehow a calculated misdeed on the part of the contractor) to allow amendment of the community agreements. Instead, the mission was very involved in the conscious decision to amend the community agreements to allow for additional voluntary eradication and the addition of new members to the community rosters.

In retrospect, the mission still strongly believes that allowing amendment of the agreements was the correct programmatic course to follow, and the very successful outcome of the voluntary eradication program in the intervening years confirms that the mission’s choice was the correct one. The agreements were amended with the full knowledge and concurrence of the mission (with the involvement of the Mission

Director), and the contract CTO communicated that decision to the contractor. The fact that the community agreements (which were signed between DEVIDA, representing the GOP, and the communities) did have a clause that said that they could not be amended was a technicality that in no way affected the eligibility of expenditures made by the contractor under those amendments.

The RIG's choice of word for the addendums as "scheme" reveals an inadequate understanding of the dynamics of voluntary eradication and the reality that it is not feasible in many cases to achieve 100 percent eradication following the first intervention in a community. Addenda were not schemed to add names to inflate the number of beneficiaries, but represent a considered and reviewed methodology to deal with the coca that was not declared in the original agreement with the community. While USAID and Chemonics discovered that in one isolated area Chemonics field staff were encouraging farmers to sub-divide their land to increase bonuses, there is no evidence that this practice was widespread. All references to this as a "widespread practice" should be eliminated until the financial review audit makes a reasoned, objective and well-documented determination.

Page 12, paragraph 1: In this paragraph dealing with the unfortunate practice of one group of Chemonics employees of encouraging program beneficiaries to subdivide their coca parcels (to increase cash payments), the RIG fails to acknowledge or mention that Chemonics, upon discovering this improper practice, immediately sent a team to investigate the problem and halted all eradication in the area for the remainder of the year. With great difficulty, the affected region's unmet coca target was assigned to the other regional offices. This section also refers to a "sample" of 13 communities that the local auditing firm reviewed in the Ucayali region as if it were a random sample of communities instead of the clarifying that the auditing firm was sent to those communities precisely because those were the communities that were identified as the epicenter of the fraudulent practice. As such, noting that 78 percent of the names on those community lists were somehow fraudulent gives the false impression that this outcome could be generalized throughout the wide regions of the program.

Page 13, paragraph 1: The RIG writes that: "Chemonics and USAID/Peru staff members were willing to overlook this agreement provision so that community members who decided to join the program at a later date could be added to the lists and receive cash payments." In fact, USAID's only oversight was to not edit the original agreements to allow changes or additions to the agreements as an acknowledgment of the programmatic reality of the undeclared coca phenomenon. As the program advanced, it was clear that a significant number of communities were not declaring all of their coca because of the presence of narcotics interests and a deep mistrust of outside institutions. USAID/Peru and Chemonics met on this issue many times and decided to permit addenda to manage the issue of undeclared coca. The only alternative to this was to have the GoP forcefully eradicate the coca, which was extremely costly and unrealistic or to leave the coca in the communities. USAID/Peru wanted to clear illegal coca from the area and thus decided to allow the contractor to return to the communities and negotiate undeclared coca. This is a reasonable response to evolving facts on the ground as the Mission and Chemonics became aware of them.

Page 15, paragraphs 2 and 3: It is unfortunate that the RIG devotes such a small space to the programmatic successes of the alternative development program. While USAID/Peru recognizes some serious implementation problems and limited mishandling of cash payments, there is much to celebrate on the changes that are occurring in former coca-growing regions. Three of the four members of the audit visited the field

and experienced first hand the programs' challenges and successes. The team that went to San Martin visited 10 Communities and spoke with many beneficiaries. Without exception, the beneficiaries spoke of how the ADP had changed their lives for the better; how coca had brought violence and fear and how the ADP had turned this around. It is regrettable that all of these positive experiences are totally ignored in the audit.

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