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OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/PERU'S ALTERNATIVE DEVELOPMENT PROGRAM

AUDIT REPORT NO.1-527-06-001-P
DECEMBER 13, 2005

SAN SALVADOR, EL SALVADOR



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FROM THE AMERICAN PEOPLE
Office of Inspector General

December 13, 2005

MEMORANDUM

TO: USAID/Peru Director, Hilda Arellano
USAID/Peru Regional Contracting Officer, James Dunlap

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

SUBJECT: Audit of USAID/Peru's Alternative Development Program (Report No. 1-527-06-001-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 16 recommendations intended to improve implementation of the Alternative Development Program. Based on your comments and documentation provided, final action has been taken on Recommendation No. 8 and management decisions have been reached for Recommendation Nos. 2, 3, 4, 5, 10, and 13. Management decisions for Recommendation Nos. 1, 6, 7, 9, 11, 12, 14, 15 and 16 can be recorded when USAID/Peru has developed a firm plan of action, with target dates, for implementing the recommendations. In this regard, please advise us in writing, within 30 days, of the actions planned to implement these recommendations. 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.

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SUMMARY OF RESULTS

As part of its fiscal year 2005 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions:

- Were USAID/Peru's Alternative Development Program activities on schedule to achieve planned sustainable results?
- Were USAID/Peru's Alternative Development Program activities managed in an efficient manner?

With respect to the first question, based on performance during 2004, USAID/Peru's Alternative Development Program activities were on schedule to achieve planned sustainable results for two of the four main results indicators (namely, the number of hectares of illicit coca voluntarily eradicated and number of program clients who remain coca free). The performance target for the number of hectares of illicit coca voluntarily eradicated was met in 2004 only because the original target was substantially reduced. Alternative development activities were not on schedule to achieve planned results for the other two main indicators (total hectares of illicit coca in Peru and the population involved in coca production). It should be noted that both of these indicators were susceptible to many influences other than USAID's alternative development activities. We could not determine if activities were on schedule to meet targets for 2005 because only annual targets had been established and four months remained in 2005 at the time of our audit. Since no interim targets or schedules were established to be met by August 31, 2005, or by any other date during 2005, there were no agreed-upon standards available for measuring progress during 2005 to date. (See pages 6 to 8.)

There were two overarching reasons why the program had not been more successful: more effective host government support was needed and a better strategy for targeting communities and for verifying eradication needed to be developed. Our report also describes an inconsistency between the contract terms and the award fee plan, a lack of rigor in developing voluntary eradication targets, reliance on cash payments to community members which do not have a clear link to sustainable development activities and are susceptible to fraud, some instances where infrastructure projects promised to communities were not delivered, some instances where infrastructure projects met recreational and/or aesthetic needs but were not linked to economic development, and a lack of maintenance plans for infrastructure projects. (See pages 8 to 25.)

With respect to the second question above, Alternative Development Program activities were not managed in an efficient manner. The report describes cases where USAID/Peru's contractor, Chemonics International, Inc., continued to provide benefits to communities that had stopped complying with their eradication agreements and also describes a need to limit benefits to communities that have not yet eradicated their coca, a need to bring the benefits provided to communities into a more reasonable relationship with the amount of coca eradicated by the communities, and a need to better control administrative costs associated with the program. (See pages 25 to 32.)

This report contains the following recommendations for USAID/Peru:

- Develop an action plan to obtain needed support from the Government of Peru. (See page 10.)
- Develop a better strategy for targeting communities with larger amounts of coca and develop a better method for verifying that all coca has been eliminated. (See page 13.)
- Seek agreements from communities to eradicate all of their coca at one time, rather than in phases. (See page 14.)
- Increase the weight assigned to key measurements of success (voluntary eradication of coca and the number of clients that remain coca free) to at least 50 percent of the award fee pool. (See page 15.)
- Modify the contract with Chemonics to reflect revised voluntary eradication targets and ensure that the revised targets are consistently described. (See page 17.)
- Establish voluntary eradication targets for calendar years 2006 and 2007 that are achievable and realistic, but not set too low that they become irrelevant to the program objectives. (See page 17.)
- Develop a plan to transition the cash payment program into a program that promotes more sustainable income generation. (See page 19.)
- Ensure that the program can deliver infrastructure projects before signing agreements with communities, provide clear boundaries to implementing partners on what can be promised to communities, and modify the standard agreements with communities to include language stating that the infrastructure projects can only be delivered after necessary environmental assessments are performed. (See page 21.)
- Ensure that Chemonics establishes guidelines for the types of infrastructure works that contribute to the program goal of generating licit economic activities. (See page 23.)
- Require Chemonics to include in the community agreements a requirement for communities to develop and implement maintenance plans, ensure that Chemonics assists communities in developing maintenance plans, and ensure that the potable water system in Ricardo Palma, Peru, is repaired. (See page 25.)
- Make a management decision with regard to ineligible questioned costs of \$225,037 (representing payments to non-compliant communities) and recover the amounts determined to be unallowable. (See page 26.)
- Limit benefits provided to communities until the communities have completely eradicated their coca. (See page 28.)
- Establish reasonable limits on the investments made in the communities. (See page 29.)

- Require community contributions (e.g., in-kind contributions) to infrastructure projects. (See page 29.)
- Conduct a personnel assessment to determine the level of staffing required to implement the program and determine if the salaries are reasonable, and monitor to verify that Chemonics International, Inc. transitions its international staff to local staff as intended. (See page 32.)
- Make a management decision with regard to ineligible questioned costs of \$2,487 (representing raises for Chemonics staff that were not reasonable) and recover the amounts determined to be unallowable. (See page 32.)

USAID/Peru disagreed with some of the conclusions in our draft audit report but believed that the report contained many useful recommendations for strengthening the Alternative Development program. Our evaluation of management comments is provided after each finding and recommendation in the report. USAID/Peru's comments in their entirety are included in Appendix II.

BACKGROUND

The U.S. Government made a large commitment to fighting drug production and narcotics trafficking throughout the Andean Region with the inauguration of Plan Columbia in 2000. As successes were achieved in Colombia, narcotics traffickers aimed at neighboring countries such as Ecuador and Peru to diversify their source of raw material. A slight rise in illicit coca production in Peru in 2002 caused the U.S. and Peruvian governments to adjust their counter-narcotics strategy. For the first time, selected development activities were directly linked to voluntary coca elimination. USAID and the Government of Peru's counter-narcotics organization, the *Comision Nacional para el Desarrollo y Vida Sin Drogas* (DEVIDA) signed a bilateral agreement in September 2002 to implement the Alternative Development Program. DEVIDA was 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. This agreement programmed approximately \$300 million in Andean Counter-Narcotics Initiative funds from 2002 through 2007 to achieve USAID's special objective of "sustained reduction of illicit coca crops in target areas of Peru."

At the end of 2002, USAID initiated a pilot voluntary eradication activity and a short-term community support activity, financed through the Andean Counter-Narcotics Initiative. USAID signed a \$50 million, 18-month agreement with Chemonics International Inc. (Chemonics) to implement these activities. Then in March 2004, a follow-on contract was signed with Chemonics International, Inc. for \$102 million from March 2004 through September 2007. As of August 31, 2005, according to USAID/Peru, \$93 million had been spent from the total \$152 million obligated for both contracts.

The program reflected a long-term U.S. Government counter-narcotics strategy composed of four elements: (1) law enforcement, (2) interdiction, (3) eradication aimed at disrupting narcotics trafficking, and (4) alternative development interventions aimed at increasing the licit economy and social stability in target areas. With results to be achieved within six years, alternative development and law enforcement programs were planned to work together to convince poor, rural farm families cultivating coca to abandon the illicit coca economy by voluntarily eradicating the plant, and at the same time to participate in development activities that produce rapid results. The strategy envisioned that coca would be permanently abandoned through a combination of USAID-stimulated alternative licit economic opportunities and improved social conditions, and U.S. Government-supported voluntary and forced eradication and interdiction measures.

The Alternative Development Program was implemented through coordination with various entities and organizations. As previously stated, the program was implemented primarily through a contract with Chemonics. Chemonics was to manage the implementation process; to ensure implementation was carried out in a coordinated, transparent, and rapid manner, in accordance with USAID rules and regulations; and to ensure that the agreed-to-activities were achieving the anticipated results and impacts. Chemonics worked with community leaders and potential program beneficiaries to encourage communities to commit to voluntary coca eradication. Chemonics then presented community agreements to DEVIDA for signature with community leaders.

Once the communities signed agreements, Chemonics made sub awards (contracts and grants) to local organizations to implement the activities stipulated in the agreements. These activities included construction of social and economic infrastructure, as well as technical assistance to develop sustainable economic activities as alternatives to coca production.

The State Department's Narcotics Affairs Section (NAS) and the Government of Peru's agency for forced eradication CORAH (*Control y Reduccion de la Coca en el Alto Huallaga*) were responsible for providing forced eradication and interdiction measures involving communities that were not willing to undertake voluntary eradication. CADA, (*Cuerpo de Asistencia para el Desarrollo Alternativo*) funded by NAS, was a Government of Peru entity responsible for identifying communities with coca production and measuring coca fields before and after eradication. PETT, (*Proyecto Especial de Titulacion de Tierras y Catastro Rural*), a component of the Government of Peru's Ministry of Agriculture, was responsible for providing assistance with the program's land titling activities.

AUDIT OBJECTIVES

As part of its fiscal year 2005 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions:

- Were USAID/Peru's Alternative Development Program activities on schedule to achieve planned sustainable results?
- Were USAID/Peru's Alternative Development Program activities managed in an efficient manner?

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

AUDIT FINDINGS

Were USAID/Peru’s Alternative Development Program activities on schedule to achieve planned sustainable results?

Based on performance during 2004, USAID/Peru’s Alternative Development Program activities were on schedule to achieve planned sustainable results for two of the four main results indicators (namely, the number of hectares of illicit coca voluntarily eradicated and number of program clients who remain coca free). The performance target for the number of hectares of illicit coca voluntarily eradicated was met in 2004 only because the original target was substantially reduced. Alternative development activities were not on schedule to achieve planned results for the other two main indicators (total hectares of illicit coca in Peru and the population involved in coca production). It should be noted that both of these indicators were susceptible to many influences other than USAID’s alternative development activities. We could not determine if activities were on schedule to meet targets for 2005 because only annual targets had been established and four months remained in 2005 at the time of our audit (which ended on September 8, 2005). Since no interim targets or schedules were established to be met by August 31, 2005, or by any other date during 2005, there were no agreed-upon standards available for measuring progress during 2005 to date.

The following table shows the available information on planned and actual results as of December 31, 2004 and August 31, 2005.

Table 1: Planned vs. Actual Results

Main Indicators ¹	Calendar Year 2004 Targets and Results			Calendar Year 2005 Targets and Results		
	Original Target	Revised Target	Actual	Original Target	Revised Target	Actual (as of 8/31/05)
Number of Hectares of Illicit Coca Voluntarily Eradicated	8,000	2,700	2,728	8,000	3,000	362 ²

¹ These were the four main performance indicators for the Alternative Development Program, as identified in the contract with Chemonics, and were considered by USAID/Peru and Chemonics (and us) to be the key indicators of success for the program. These four indicators, which fell under the largest contract line item (auto-eradication), were budgeted for approximately 85 percent of the contract budget excluding start-up, situational response, and monitoring performance costs. The other indicators, which fell under the second largest contract line item (willingness to reject coca increased) were budgeted for approximately 15 percent of the contract budget excluding the same elements noted above and included the number of communities signing and complying with coca elimination agreements, the number of families who agreed to eradicate their coca, the cumulative percentage of target families who agreed to eradicate their coca, and the percentage of the target population that accepted the need to eliminate coca in their community.

Main Indicators ¹	Calendar Year 2004 Targets and Results			Calendar Year 2005 Targets and Results		
	Original Target	Revised Target	Actual	Original Target	Revised Target	Actual (as of 8/31/05)
Number of Program Clients Who Remain Coca Free	23,500	23,500	27,704	30,000	30,000	28,670
Total Hectares of Illicit Coca in Peru	27,000	27,000	27,500 - 50,300 ³	21,000	21,000	Not available
Population Involved in Coca Production	29,700	29,700	52,755	23,100	23,100	Not available

Additional information on the program indicators is presented in Appendix III.



Photo taken by an OIG auditor on August 31, 2005 of a voluntarily eradicated coca field, in Ricardo Palma, Peru.

² A casual perusal of the available performance information might lead the reader to conclude that the program will fall far short of its revised target of eradicating 3,000 hectares of coca during 2005 since only 362 hectares had been eradicated by August 31, 2005. Such a conclusion might be premature. Mission officials expect activity to accelerate and noted that, in 2003, 3,962 hectares were eradicated during the last four months of the year – 81 percent of all the hectares eradicated in that year. However, in the following year, 2004, only 1,100 hectares, or 40 percent of the hectares eradicated in 2004, were eradicated in the last four months of the year. USAID/Peru and Chemonics were hopeful that the voluntary eradication target will be met. In its comments on our draft report, the Mission stated that, as of November 7, 2005, 1,062 hectares have been eradicated during 2005

³ The lower estimate is from a Central Intelligence Agency (CIA) Crime and Narcotics Center survey and the higher estimate is from the United Nations Office on Drugs and Crime's *Peru Coca Cultivation Survey* dated June 2005. According to ADP program monitoring and evaluation staff, the higher estimate is considered more accurate since the CIA survey did not account for new areas of coca grown in Peru.

For the year ended December 31, 2004, the program was responsible for voluntary eradication of 2,728 hectares of coca as compared to a revised target of 2,700 hectares and the original target of 8,000 hectares. As is discussed in more detail in the section beginning on page 16, the original target was seen by USAID/Peru as unrealistic and overly aggressive. However, the Mission did not amend the contract with Chemonics to reflect the new target or document the basis for the new target. During 2004, the number of Alternative Development Program (ADP) clients who remained coca free (i.e., the number of residents of communities that were complying with their agreements with the ADP) increased to 27,704, exceeding the target of 23,500. As compared to the other two main results indicators discussed below, these results indicators were more directly influenced by the ADP program. According to the contract with Chemonics, these were considered the key measurements of success for the program and performance against these indicators was to determine a significant portion of the award fee paid to Chemonics. However, as discussed in the section below beginning on page 15, the award fee actually paid was based on more subjective factors.

The program did not meet planned targets for reducing the total number of hectares of illicit coca in Peru: during 2004, according to the United Nations report cited in footnote number 3, there were 50,300 hectares of illegal coca at the end of 2004 versus a target of 27,000 hectares. The program also did not meet the target for reducing the population involved in coca production: at the end of 2004, DEVIDA estimated that 52,755 Peruvians were involved in coca production versus a target of 29,700 for 2004. This estimate also exceeds the estimated 40,260 Peruvians who were involved in coca production in 2002, before the ADP program began.

The following sections of the report, through page 25, discuss the major factors that limited the results achieved by the ADP program.

More Effective Host Government Support Was Needed

Summary: The Government of Peru and USAID/Peru signed a bilateral agreement to pursue a counter-narcotics strategy to improve the licit economy, improve access to social services, and to disrupt narcotics trafficking through interdiction and eradication. Certain functions, such as law enforcement and forced eradication, can only be carried out by the Government of Peru. Without effective support by the Government of Peru, the Alternative Development Program will face extremely difficult challenges. More effective support from the government is needed to provide a secure environment in coca-producing regions, to present a credible threat of forced eradication for those who do not consent to voluntary eradication, and to advance the program's land-titling component. Several factors have constrained the effectiveness of the government's support for the program, including a lack of resources, the current administration's relatively narrow base of political support, and upcoming Presidential elections scheduled for April 2006. A stronger, responsive state presence in coca-producing regions could do much to advance the ADP project.

As noted in the background section, the ADP program is part of a long-term U.S. Government counter-narcotics strategy that includes law enforcement, interdiction, eradication, and alternative development interventions. None of the elements of this strategy can operate effectively unless the Government of Peru can exercise its authority in regions where coca is cultivated and provide a secure environment. Moreover, certain

functions, such as law enforcement and forced eradication, can only be carried out by the Government of Peru within its territory. The interrelationship between the ADP program and other elements of the strategy was formally recognized in the bilateral agreement for the ADP program which states that “the Governments of Peru and the United States are pursuing a joint, long-term counter narcotics strategy composed of two interdependent elements: (1) efforts to increase the licit economy and improve access to social services in participating communities; and (2) law enforcement efforts, including interdiction and eradication aimed at disrupting narcotics trafficking, lowering the farm-gate price of coca leaf, and reducing the area dedicated to coca production.” In sum, without effective support from the Government of Peru, the Alternative Development Program cannot achieve sustainable results.

It was evident that more effective support from the Government of Peru was needed to advance the ADP program. First, difficult security conditions in the areas where coca is cultivated have impeded implementation of the ADP program. During the year ending March 2005, Chemonics suspended activities in its regional offices for a total of 206 days due to hazardous situations and threats such as murder, armed robbery, lockouts, strikes, blocked roads, and acts of terrorism.⁴ Because of inadequate security, Chemonics plans to focus future program activities on only two of the original four regions. Moreover, insecurity in coca producing regions enhances the standing of narco-trafficking organizations as rivals or potential rivals of the government in these regions and diminishes the prestige and authority of the government in comparison.

Second, the pace of forced eradication efforts by the Government of Peru has been somewhat inconsistent at times. For example, at the outset of 2005, only about 125 hectares of coca per month was forcibly eradicated. However, the pace of forcible eradication has recently accelerated and, in July 2005, 1,300 hectares of coca was eradicated. Forced eradication, or at least a credible threat of forced eradication, changes the incentives that farmers face and makes voluntary eradication through the ADP program more attractive. Coca is a hardy plant that is easy to grow and finds ready markets. An alternative crop such as cocoa can rival its profitability but require several years to become profitable. By increasing the perception of risk associated with coca cultivation, the threat of forced eradication makes alternative crops more attractive.

Third, and in addition to providing a more secure environment and stepping up forced eradication efforts, the Government of Peru needs to better support the ADP program’s land titling activity. On August 27, 2003, Chemonics and PETT, (*Proyecto Especial de Titulacion de Tierras y Catastro Rural*, a component of the Ministry of Agriculture) entered into an agreement to implement land titling activities. Land titles strengthen the property rights of farmers and facilitate investments in crops that require long lead times to become profitable. Land titles also help farmers convert land into cash flows by selling, leasing, or mortgaging it. Unfortunately, the agreement did not specifically describe the responsibilities of Chemonics and PETT for the land titling activity. As of August 31, 2005, Chemonics had spent \$3.3 million to help 6,127 beneficiaries obtain titles, but PETT had only issued titles to 881 beneficiaries. PETT has requested additional support in exchange for additional land titles, requests which Chemonics and

⁴ The 206 days were distributed as follows: Aguaytia 84 days, Tocache 70 days, Tingo Maria 26 days, and VRAE 26 days.

USAID/Peru view as unwarranted. In light of the lack of progress by PETT, USAID/Peru has suspended funding for land titling activities.

Several factors have constrained the Government of Peru's support for the ADP project. As in all developing countries, the resources available to the government are extremely limited in relation to needs. Peru is a large country with a great deal of inhospitable, rugged terrain, and narco-traffickers typically concentrate their activities in the most remote areas. Providing for substantially improved access into these regions would require a significant investment and the costs of controlling this territory would be significant as well. In addition, coca eradication is not universally popular in Peru: within the regions targeted by the ADP project, a 2004 DEVIDA survey showed that only 66 percent of the population recognized the negative consequences of illicit coca cultivation and only 43 percent accepted the need to eliminate coca in their community. Due to its rather narrow base of support and upcoming Presidential elections scheduled for April 2006, the Toledo administration is not ideally positioned to exert strong leadership. Indeed, support for counter-narcotics activities, and the ADP project in particular, cannot be taken for granted even within the government: for example, a ranking official in DEVIDA expressed to us the opinion that alternative development activities should not be linked to voluntary eradication and U.S. Government officials we interviewed believe that some Government of Peru officials still do not believe that coca cultivation is a Peruvian problem but rather a U.S. problem. Finally, given the level of resources that narco-traffickers can command, corruption of individual law enforcement officials is a possibility that cannot be dismissed.

The factors described in this section have impeded the progress of the ADP project. As is discussed in the section above beginning on page 6, the number of Peruvians involved in coca cultivation has increased substantially since the ADP project began in 2002. A stronger, responsive state presence in coca-producing regions, as well as better support for land titling activities, could do much to advance the ADP project.

Recommendation No. 1: We recommend 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.

Evaluation of Management Comments – In response to our draft report, USAID/Peru stated that the Mission and NAS are moving forward with a joint plan to leverage increased Government of Peru support. The plan envisions that USAID/Peru will begin to fund alternative development activities for communities that have undergone forced eradication and are willing to sign agreements stating that they will not replant coca. Helping to provide licit economic opportunities for these communities should make forced eradication efforts more permanent. Providing alternative development activities in conjunction with forced eradication efforts will also allow the Government of Peru to soften the image of forced eradication efforts and blunt possible criticisms of forced eradication. As part of this initiative, the Government of Peru has agreed to make clear to the involved communities that they will not be allowed to replant coca and has agreed to return to the affected areas to re-eradicate as necessary. This plan is to be implemented first in Pizana/Polvera, a hard-core coca-growing area where a major forced eradication campaign was just completed. It is hoped that local government leaders will take a more prominent role in eradication and alternative development activities in their communities, strengthening the authority of the government and ultimately leading to improved security.

A management decision will be reached for Recommendation No. 1 when USAID/Peru develops a firm plan of action to obtain the needed support from the GOP in the areas where the ADP project is currently working. It would be very helpful if this plan specifically addressed the land titling activity.

A Better Strategy for Targeting Communities and Verifying Eradication Efforts Was Needed

Summary: The success of the ADP program is dependent on the strategy for targeting communities and then verifying that the communities have eradicated their coca. However, the current strategy, requiring communities to disclose where their coca fields are and then requiring CADA technicians to visit the fields repeatedly to verify eradication, constrains the effectiveness of voluntary eradication efforts and introduces inefficiencies into program operations. This strategy was developed after CADA proved unable to reliably analyze satellite imagery and was also driven by a requirement to verify eradication which occurs in phases rather than at one time. As a result, any coca fields not disclosed by the communities themselves were unknown and unmeasured, and millions of dollars were spent in communities that had very little or no coca because the program was unable to target areas with high concentrations of coca.

The effectiveness of the ADP program in encouraging voluntary eradication depends heavily on the program's strategy for identifying and targeting communities that are cultivating large amounts of coca. Conversely, if the program lacks an effective strategy for identifying high-value targets, it is likely that less coca will be eradicated and resources may be misdirected toward communities that are cultivating negligible amounts of coca. Efficiency issues also arise in the verification of voluntary eradication efforts: obviously, it is desirable to accomplish this verification as efficiently as possible so as to preserve program resources to advance ADP program objectives.

Originally, Chemonics relied on CADA (*Cuerpo de Asistencia para el Desarrollo Alternativo*), to identify communities with significant coca production. Unfortunately, the information provided by CADA was unreliable. CADA analyzed satellite imagery to identify coca fields and estimate their extent. Based on this information, the program identified areas with larger amounts of coca production and began negotiations with communities to voluntarily eradicate their coca fields in exchange for community developmental assistance. However, when eradication efforts began, USAID officials learned that CADA's analyses of satellite imagery were flawed. To cite an example, CADA's analysis of satellite imagery indicated that there were 609 hectares of coca production in one area. From that amount, 100 hectares of coca was forcibly eradicated. The remaining 509 hectares was determined by Chemonics to be a prime target for voluntary eradication. However, when final measurements were taken by CADA technicians on the ground, only about 75 hectares of coca were found.



Photograph taken by an OIG auditor on September 2, 2005, of CADA field technicians demonstrating the coca measurement process in San Reyes, Peru. This photo hints at but does not fully convey the difficulties of access in coca producing regions. Reaching coca fields can require hours of travel on foot through dense jungle in mountainous terrain.

When the information provided by CADA proved to be unreliable, Chemonics then began to rely on the communities themselves to identify coca fields. When a community agreed to participate in the voluntary eradication program, they would send a letter of invitation to CADA. CADA would then visit the coca area and measure the coca that had been declared by the communities. Once the coca had been eradicated, CADA would return to the community to verify the amounts that had been eradicated. This methodology also proved to be unreliable because communities often inflated their estimates of coca production in order to be chosen to receive developmental assistance. For example, two communities each declared 200 hectares of coca, but when CADA arrived to measure the area, only 9 hectares of coca was present in one community and none in the other. Furthermore, manual measurement of declared coca fields does not provide assurance that all coca has been eliminated from an area since CADA only measures amounts declared by the communities. Any coca fields that are not disclosed to CADA are unknown and unmeasured.

Once communities report that they have eradicated their coca, CADA must verify that the coca is actually eradicated. However, the verification process performed by CADA was inefficient since the communities were not expected to eradicate all their coca at one time, but rather in phases. As the community made progress in eradicating its coca, the community was rewarded with community development assistance. Therefore, CADA was expected to verify the coca eradicated after each phase, which meant returning to the same coca fields several times. This process was inefficient and time consuming. While community members may live and gather together in some central location, a community's coca fields can be located miles from the community center. It often takes several hours to travel to the communities and then approximately one to six hours on foot each way to travel from the communities to the coca fields. At times, this has caused significant delays and backlogs in measuring the coca eradicated. This was an inefficient use of resources and demonstrated the need for a better method of verification.



Photograph taken by an OIG auditor on August 31, 2005, of the central community gathering location in Achinamiza, Peru.

This unwieldy strategy for targeting large coca fields and verifying completed eradication efforts came about primarily because of the requirement for CADA to revisit communities several times to verify eradication in phases. Another cause was CADA’s inability to reliably analyze satellite imagery. According to the State Department’s Narcotics Affairs Section (NAS), CADA has over time significantly improved its ability to analyze satellite imagery for coca. NAS officials stated that CADA’s results are now approaching 95 percent accuracy. In addition, NAS has funded for one year an aircraft to test whether more current and accurate information can be obtained through aerial imaging. CADA is currently in the process of outfitting this aircraft with instrumentation.

Without a better method of targeting coca fields and verifying voluntary eradication, USAID/Peru will be unable to achieve its goals. Millions of dollars were spent in communities that had very little or no coca because Chemonics was unable to effectively target communities with high amounts of coca.

The program spent approximately \$22 million for 257 communities, out of a total of 385 communities assisted as September 8, 2005, that had less than 20 hectares of coca eradicated. The table below shows the amount spent in communities that had little or no coca:

Table 2: Funds Spent On Communities That Had Little or No Coca

Hectares of Coca Eradicated	Funds Spent	Number of communities
0-4.9	\$6,568,870	103
5-9.9	\$8,228,980	81
10-20	\$7,525,929	73
Totals	\$22,323,779	257

Recommendation No. 2: We recommend that USAID/Peru in coordination with the State Department’s Narcotics Affairs Section (NAS), CADA (Cuerpo de Asistencia para el Desarrollo Alternativo), DEVIDA (Comision 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.

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

Evaluation of Management Comments – In its comments on the draft report, USAID/Peru stated that, during the initial phase of the ADP program, the program was deliberately designed to include communities that had relatively small amounts of coca, in addition to communities with larger concentrations of coca, to avoid any possible perception that the program was rewarding communities who were most heavily involved in illicit coca production. Further, in the Mission's judgment, eradication in the most hard-core communities would have been too destabilizing because of the social unrest that would have followed eradication efforts. Since that time, the Mission has taken cautious steps to make the program more efficient.

In response to Recommendation No. 2, USAID/Peru stated that, for 2006, the Mission and NAS plan to pursue new methodologies for targeting coca for voluntary eradication. First, NAS has new surveillance capability in an airplane equipped with a camera and Global Position System. NAS will perform over flights in areas suspected to have dense concentrations of coca, map the coca, and give the information to USAID, so that USAID's contractor can approach the local authorities and the communities about the voluntary eradication program. Secondly, the program will procure satellite photographs, CADA will analyze them, and Chemonics will verify the analysis on the ground.

For the verification step of the voluntary eradication program, USAID/Peru stated that the Mission, NAS, CADA, and Chemonics have already initiated a more efficient and more effective methodology. When a community is ready to eradicate, CADA returns to the community and supervises the eradication as it is happening. To date in the 2005 voluntary eradication program, according to USAID/Peru, virtually all communities have eradicated all at once, reducing the number of times that CADA has to return to a community.

In commenting on Recommendation No. 3, USAID/Peru agreed with the audit finding that it would be more efficient and cost effective for communities to eradicate their coca at one time. However, the Mission believes that the Supreme Decree signed by President Toledo in April 2003 does not allow the program to insist on eradication of all of the coca in communities at once. Nevertheless, the Mission stated that communities may choose to eradicate at one time and USAID, through its contractor, will continue to encourage communities to do so. As stated above, for 2005, virtually all communities have chosen to eradicate all at once. Based on USAID/Peru's comments, we have modified our recommendation from requiring communities to eradicate all their coca at once to seeking agreements from communities to eradicate all of their coca at once.

Based on the information provided by USAID/Peru, we consider that management decisions have been reached for Recommendation Nos. 2 and 3. Determination of final action for these recommendations will be made by the Audit Performance and Compliance Division (M/CFO/APC).

Award Fee Plan Was Inconsistent with Contract Terms

Summary: The contract between USAID/Peru and Chemonics International, Inc., signed on March 17, 2004, contained a possible award fee of \$5.1 million. Progress against two key results indicators (the number of hectares of coca eradicated and the number of clients who remained coca free) was to determine a significant portion of the contractor's award fee. However, the award fee was based primarily on contractor effort rather than results. This occurred because the Mission did not use the contract as a reference in preparing the award fee plan and also because mission staff were not comfortable using objective factors like the number of hectares of coca eradicated to measure the contractor's performance for purposes of determining the award fee. As a result, there were weak incentives for good contractor performance because the contractor was not primarily rewarded for achieving results.

The contract between USAID/Peru and Chemonics International, Inc. signed on March 17, 2004, contained a possible award fee of \$5.1 million. The contract stated that, performance measures for the achievement of annual targets against the number of hectares eradicated and the number of clients who remain coca free are considered the key measurements of success for the overall Alternative Development Program. Progress against these two indicators would determine a significant portion of the contractor's award fee. USAID/Peru determined the award fee earned and payable annually.

However, the award fee plan, developed five months after signing the contract, was based primarily on subjective and qualitative factors instead of eradication results. It was based on quality of product or service, timeliness of performance in eradication targets and inputs, such as communications and behavior change, monitoring and evaluation, land titling, customer service and business relations, and cost control. Of these factors, the percentage weight allocated to the achievement of voluntary eradication was relatively low (15 percent of the total award pool) in comparison to the weight applied to the other factors.

The Mission did not use the contract as a reference in preparing the award fee plan. Furthermore, mission staff were not comfortable with using objective measures like the number of hectares of coca voluntarily eradicated to determine the award fee to be paid to the contractor. They were more comfortable with rewarding the contractor based on effort. As a result, there were weak incentives for good contractor performance because the contractor was not primarily rewarded for achieving results.

Recommendation No. 4: We recommend 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.

Evaluation of Management Comments – In response to Recommendation No. 4, USAID/Peru agreed with the recommendation and stated that the Award Fee Plan for 2006 and 2007 will stipulate that 50 percent of the award fee pool will be assigned to meeting the eradication target and the number of clients who remain coca-free. USAID/Peru considers it too late in the calendar year to change the Award fee Plan for 2005.

We consider that a management decision has been reached for Recommendation No. 4. Determination of final action will be made by M/CFO/APC.

Targets for Voluntary Eradication Were Not Properly Documented

Summary: It is important to the success of any program for program goals to be unambiguous and expressed consistently, a principle that is reflected in the ADS. The targets for voluntary coca eradication were significantly reduced but the Mission did not document why the targets were reduced, when they were reduced, or the basis for determining the revised targets. In addition, the contract, the performance monitoring plan, and the award fee plan all showed different targets. This occurred because of weak management by USAID/Peru. A lack of well established and documented targets can contribute to poor program performance.

According to Automated Directives System (ADS) 203.3.8.4 Annual Report Operating Unit Performance Assessment, the designation of targets must be fully documented in a decision memorandum signed by the director or designee of the Operating Unit. Furthermore, ADS 203.3.3 states that each indicator in a performance monitoring plan “should include performance baselines and set performance targets that can optimistically but realistically be achieved within the stated timeframe and with the available resources.” Also, “targets should be ambitious, but achievable given USAID (and other donor) inputs. Operating units should be willing to be held accountable for achieving their targets. On the other hand, targets that are set too low are also not useful for management and reporting purposes.” Beyond what is specifically stated in the ADS, it is obviously important to the success of any program for program goals to be unambiguous and expressed consistently.

According to the contract signed between USAID/Peru and Chemonics International, Inc. on March 16, 2004, the target for voluntarily eradicating coca in Peru was 8,000 hectares per year for calendar years 2004 through 2007. USAID officials stated that, at the time the contract was signed, it was estimated that there were 32,000 hectares of coca in Peru and the Mission wanted to eradicate all of it during the life of the ADP program. Therefore, the Mission simply divided the 32,000 hectares of coca by the four years of the program to arrive at a target of 8,000 hectares to be voluntarily eradicated each year. Nonetheless, this original target was always seen by mission officials as unrealistic and overly aggressive. The target was subsequently reduced but the Mission did not document why the target was reduced, when it was reduced, or the basis for determining the revised targets. In addition, the contract, the performance monitoring plan, and the award fee plan all showed different targets:

Table 3: Coca Eradication Targets per Mission Documents

Mission Documents	Targets for CY 2004	Targets for CY 2005
Contract between USAID/Peru and Chemonics signed on March 16, 2004	8,000	8,000
Performance monitoring plan dated June 2003 and	5,000	5,000

Mission Documents	Targets for CY 2004	Targets for CY 2005
revised September 2004		
Award fee plan signed on August 30, 2004 and draft award fee plan for calendar year 2005	2,700	3,000

This situation occurred because of weak management by USAID/Peru. We concluded that neither the original nor the revised targets were established through any rigorous process for determining what could realistically be achieved through the ADP program. Moreover, given the differences between the contract, the performance monitoring plan, and the award fee plan, it appeared to us that at least some of these documents were not actually used to manage the program.

Targets that are ambiguous or that are not set at ambitious but realistic levels can contribute to poor program performance. The Mission needs to establish targets that are achievable, yet not set too low that they become irrelevant to program management.

Recommendation No. 5: We recommend that USAID/Peru a) modify its contract with Chemonics International, Inc. to reflect the revised target, and b) ensure that the revised target is consistent among mission documents.

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

Evaluation of Management Comments – In response to our draft report, USAID/Peru agreed with Recommendation No. 5 and stated that a revised contract will be signed by the contractor in the next 30 days and all Mission documents will be reviewed and revised as needed within the next 60 days. A management decision has been reached for Recommendation No. 5 and a determination of final action on this recommendation will be made by the Audit Performance and Compliance Division (M/CFO/APC).

The Mission also agreed with Recommendation No. 6 and stated that it had established contract targets for the number of hectares of coca voluntarily eradicated of 2,500 hectares and 500 hectares for calendar years 2006 and 2007, respectively. While USAID/Peru and we are in agreement on the need to establish performance targets that are achievable and realistic, but not set too low that they become irrelevant, we are not in agreement on the levels to be established for the new targets.

If USAID/Peru's proposed new targets are accepted, then the revised eradication targets will be:

<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u> <u>(9 months)</u>
3,000 hectares	2,700 hectares	3,000 hectares	2,500 hectares	500 hectares

In our judgment, the new revised targets for 2006 and 2007 are set too low and do not meet the intent of our recommendation. In its comments on our draft report, USAID/Peru noted that the last contract year will be an abbreviated one and that the contractor will

need to devote effort to contract closeout as well as ongoing activities. These are valid considerations. Other considerations, though, would indicate that the targets for 2006 and 2007 should be set higher. First, most programs start slowly and build momentum as the implementer gains experience and staff overcome learning curves. We believe it is reasonable to expect that this would be the case with the ADP program. Second, as of August 31, 2005, \$59 million remained under the contract with Chemonics to pay for activities under for the remaining 25 months of the program, a level of resources which would appear sufficient to support a level of effort higher than what the proposed targets envision. Third, implementation of the recommendations in this audit report – for example, obtaining more effective support from the Government of Peru, developing a more efficient method of targeting communities with high concentrations of coca, establishing reasonable limits on investments in communities, obtaining counterpart contributions from communities, and limiting administrative costs – should increase the efficiency and effectiveness of program operations. All of these considerations lead us to believe that program accomplishments should go up, not down, as the program progresses. A management decision for Recommendation No. 6 can be reached when USAID/Peru and we agree on the actions to be taken to address the recommendation.

Cash Payments Were Not Clearly Linked to Sustainable Development and Were Susceptible to Fraud

Summary: According to USAID/Peru's *Alternative Development Strategy 2003-2007*, the ADP program was designed to create a basis for sustainable and legitimate economic activity. Under the program, community members received a payment upon signing an agreement to voluntarily eradicate coca. The payment was in the form of cash or check and was distributed by Chemonics. These payments do not promote sustainable income generation for the families. In addition, this type of payment is susceptible to fraud because of the large amount of cash involved (\$5.3 million), because many individuals are involved with cash distribution, and because it is difficult to determine if individuals belong to a community for purposes of the cash distribution. The Mission used these payments as an incentive for the communities to participate in the program. As a result, funds totaling \$5.3 million were not directly linked to the program goal of sustainable development and there is a possibility of fraud that may result from these payments. In fact, Chemonics has acknowledged that the prospect of receiving these payments often attracts non-community members and encourages the arrival of relatives of community members, inflating rosters and forcing payments to persons extraneous to the community. Moreover, in several coca measurement reports, CADA officials reported that, ironically, several farmers thought that they needed to grow more coca in order to qualify for the cash payments.

According to USAID/Peru's *Alternative Development Strategy 2003-2007*, the ADP program was designed to create a basis for sustainable and legitimate economic activity: licit economic opportunities will be available through increased use of financial services, improved economic infrastructure, and the establishment of a sustained natural resource base.

However, the ADP program used cash payments totaling \$5.3 million to community members as an important incentive to voluntarily eradicate their coca. Furthermore, these cash payments had little to do with sustainable income generation for families that were formerly dependent on coca cultivation. Under the program, each community

member received cash payments totaling \$180 in three installments: 20 percent when the community signed an agreement with DEVIDA, 30 percent upon eradicating 30 percent of the community's coca fields, and the remaining 50 percent when all coca had been eradicated. Each head of household in that community, whether or not he or she grew or owned coca, would be entitled to receive the cash payments. On the day of payment, Chemonics distributed payments (in cash or check) to the community members. If the member was not present at the time of the distribution, the municipal leader of the community received the payment on their behalf and distributed the payment to them at a later date. If the payment was in the form of a check, the check could be cashed at the Chemonics' regional office. If an individual was unable to go to the regional office, he or she could assign other family members or friends to collect the money.

The payments were included in the design of the program as an incentive for the communities to participate in the program. However, subsequently some mission officials expressed concerns over the administration of the cash payment program and had expressed the desire to eliminate the cash payment program to the extent possible.

As a result, funds totaling \$5.3 million were not directly linked to the program goal of sustainable development and there is a possibility of fraud that may result from these payments. In fact, Chemonics has acknowledged in a recent quarterly progress report to USAID that the prospect of receiving these payments often attracts non-community members or encourages the arrival of community relatives, which inflates rosters and forces making payments to persons extraneous to the community. Moreover, in several coca measurement reports, CADA officials reported that, ironically, several farmers thought that they needed to grow more coca in order to qualify to receive the cash payments.

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

Evaluation of Management Comments – USAID/Peru agreed with the conclusion that resources used for cash payments could be better directed to economic infrastructure projects or the development of licit productive activities. However, nearly half of the program clients surveyed indicated that they would not have participated in the program without the incentive provided by the cash payments. Therefore, the Mission stated that it was in the process of trying to phase out the cash payments so that the resources can instead be invested in sustainable development activities.

The Mission was under the impression that there have been no indications of fraud involving the cash payments. This is not correct. In fact, Chemonics reported to the Mission in its quarterly report for April – June 2005 that “The prospects [sic] of receiving bonos [cash payments] often attracts non community members or encourages the arrival of community relatives, which inflates rosters and forces paying of bonos to persons extraneous to the community.”

The Mission also disputed CADA's reports that farmers thought they needed to grow more coca in order to receive the cash payments, noting that the payments are supposed to go to all heads of family in a community, whether each individual family is

involved in coca production or not. The Mission is correctly describing how the cash payments are supposed to work, but there is fairly widespread misunderstanding of this fact. During our audit we encountered evidence that CADA officials, individual farmers, and at least one mayor believed that individuals had to be involved in coca production in order to receive the payments.

A management decision will be reached for Recommendation No. 7 when USAID/Peru has developed a firm plan of action and a date for implementing the recommendation.

Infrastructure Projects Were Not Delivered to Seven Communities

Summary: According to the contract between USAID/Peru and Chemonics International, Inc. signed on March 17, 2004, the contractor needs to “maintain capability, via agreements and subcontracts, to promptly and efficiently deliver the benefits included in all community agreements.” However, the program did not deliver infrastructure projects promised to communities because the cost would have been too high and because of environmental concerns. The program focused on signing agreements with communities to meet voluntary coca eradication targets rather than determining whether infrastructure projects promised to communities could actually be delivered. Also, the program negotiators were not given clear boundaries on what could be promised to communities and did not have the expertise on the environmental viability and the estimated cost of infrastructure projects. As a result, community expectations were not met and the credibility of the program was damaged.

According to the contract between USAID/Peru and Chemonics, the contractor needs to “maintain capability, via agreements and subcontracts, to promptly and efficiently deliver the benefits included in all community agreements.” In the District of Chazuta, the program signed agreements with 14 communities to deliver infrastructure projects.

Chemonics agreed to rehabilitate roads for four of these communities, which would facilitate transporting their agricultural products to markets. The communities were only accessible by boat. However, Chemonics did not rehabilitate the roads because of environmental concerns and a lack of resources. According to one estimate, rehabilitating the roads would have cost about \$3 million. Therefore, more than a year after signing the agreements, Chemonics had to amend the agreements canceling these infrastructure projects and replacing them with other infrastructure projects (a potable water system, a medical post, a foot bridge, and sports courts) valued at \$293,123.

In addition, the program rehabilitated a road at a cost of about \$570,000 for three other communities in the District of Chazuta. However, the communities presumed that stream crossings would be built to cross the four large streams dissecting the road at various points. These streams are impassable during the months of heavy rains (December through March). Stream crossings were not built due to the high cost. In addition to the drawback of not reaching a clear understanding with the communities on whether or not stream crossings would be built, and therefore risking not meeting their expectations, we question the usefulness of spending \$570,000 to rehabilitate a road that can not be used four months out of the year.



Photograph taken by an OIG auditor on September 1, 2005 of a stream that cuts across a road that was rehabilitated under the ADP program, rendering it impassable during the rainy season, in Chazuta, Peru.

The program focused on signing agreements with communities to meet coca eradication targets rather than determining whether infrastructure projects promised to communities could be delivered. Also, the program negotiators were not given clear boundaries on what could be promised to communities and did not have the expertise on the environmental viability and the estimated cost of infrastructure projects.

As a result of the situations described above, community expectations were not met and the credibility of the program was damaged. This could jeopardize the program goal of convincing communities to abandon the coca economy and make the transition to a licit economy free of coca.

Recommendation No 8: We recommend 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 International, Inc. and the Government of Peru's counter-narcotics agency (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.

Evaluation of Management Comments – USAID/Peru agreed with Recommendation No. 8 and stated that as of January 2005, the program had already implemented a new standard agreement with the communities that states that all infrastructure projects are subject to an environmental assessment prior to implementation. USAID/Peru has also provided the contractor with explicit guidance as to what kinds of projects are allowable in these negotiations. A technical information sheet for every possible type of infrastructure project is included in the negotiation packet and includes information as to type and scope of the project, program and community commitments under the agreement, scheduling and any conditions precedents needed to initiate the project.

Based on the Mission's comments and the supporting documentation provided, final action has been taken on Recommendation No. 8.

Infrastructure Projects Were Not Directly Linked to Alternative Development

Summary: According to the contract between USAID/Peru and Chemonics International, Inc. signed on March 17, 2004, one of the purposes of the voluntary coca eradication model was to “maintain the communities permanently free of illicit coca, while connecting them to sustainable development opportunities.” However, the program financed some infrastructure projects that met recreational and/or aesthetic needs but did not contribute to the program goal of developing licit economic activities. For example, the program financed the construction of sports courts in two communities and improved a town plaza in another community. The program did not establish clear boundaries on the types of infrastructure works that contributed to the program goal of generating licit economic activities. Infrastructure projects that were not linked to licit economic activity were financed because Chemonics did not establish clear boundaries on the types of infrastructure works that that were permissible. In addition, USAID/Peru did not insist that Chemonics adhere to the program purpose. As a result, the program spent \$119,000 for purposes that did not contribute to sustainable development activities.

According to the contract between USAID/Peru and Chemonics International, Inc. signed on March 17, 2004, one of the purposes of the voluntary coca eradication model was to “maintain the communities permanently free of illicit coca, while connecting them to sustainable development opportunities at the local, regional, and national levels.” Once a community signed a voluntary coca elimination agreement, immediate and short-term activities would be designed to create temporary employment and income opportunities for participating community members, which included economic infrastructure (road rehabilitation and small bridges) and social infrastructure (construction of classrooms, health posts, and water and sanitation facilities), and small on-farm diversified productive activities. Subcontracts signed by Chemonics also indicated that infrastructure projects would further the program goal of encouraging licit economic activity.

However, the program financed some infrastructure projects that met recreational and/or aesthetic needs but did not contribute to the program goal of developing licit economic activities. For example, included in the 16 infrastructure projects provided to communities in the District of Chazuta were the construction of sports courts in two communities and the improvement of a town plaza in another community at a cost of approximately \$119,000 for all three projects.



Photograph taken by an OIG auditor on August 31, 2005 of a sports court constructed for a community in Achinamiza, Peru.

Infrastructure projects that were not linked to licit economic activity were financed because Chemonics did not establish clear boundaries on the types of infrastructure works that that were permissible. In addition, USAID/Peru did not insist that Chemonics adhere to the program purpose. The Mission was justifiably concerned with showing results, but in our opinion this sometimes led mission staff to make incorrect judgments about what types of investments were permissible under the program. As a result, the program spent \$119,000 for projects that did not contribute to sustainable economic development.

Recommendation No 9: We recommend 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.

Evaluation of Management Comments – In response to Recommendation No. 9, USAID/Peru stated that it agrees with the recommendation and has implemented a new negotiation process that will ensure that only infrastructure projects that contribute to the program goal of generating licit economic activities will be implemented under the program. The Mission stated that, in January 2005, it introduced a new agreement to be used in negotiations with the communities. According to the Mission, the agreement includes guidelines/checklists for community liaison workers to use when prioritizing infrastructure projects and authorizes six types of projects that can be negotiated in the agreement. They include: (i) educational infrastructure, (ii) water and sewage, (iii) health infrastructure, (iv) economic infrastructure, (v) electrification, and (vi) road rehabilitation and bridge construction. If a community or group of communities requests a project that is not part of the approved list, the contractor must receive USAID/Peru approval prior to negotiating with the communities.

In reviewing the list of authorized types of infrastructure paraphrased/summarized by the Mission, we noted one category in the actual list that is not included in the Mission's paraphrase/summation, which is "multiple use premises." This was the same category that Mission officials relied on during our audit in attempting to justify the construction of sports courts and the rehabilitation of a town plaza. Therefore, we do not believe that this list would preclude the construction of similar projects during the remainder of the project.

A management decision on Recommendation No. 9 can be recorded once the Mission reaches a firm plan of action, with target dates, for implementing the recommendation.

Infrastructure Projects Did Not Include Maintenance Plans

Summary: All USAID development activities are required to be sustainable. According to USAID's Strategy for Sustainable Development, dated October 4, 2000, "Sustainable development is characterized by economic and social growth that does not exhaust the resources of a host country...Development is 'sustainable' when it permanently enhances the capacity of a society to improve its quality of life." However, the infrastructure projects provided under the program did not contain maintenance plans to help ensure that the projects continued to function as intended.

Specifically, the contracts between Chemonics International, Inc. and its sub-contractors did not require a maintenance plan. Furthermore, the agreements between the Government of Peru and the communities to voluntarily eradicate coca in exchange for developmental assistance did not require communities to develop and implement a maintenance plan. The Mission focused on other priorities and overlooked the need to include maintenance plans in the agreements with subcontractors and the communities. As a result, the infrastructure projects could encounter major system failures.

All USAID development activities are required to be sustainable. According to USAID's Strategy for Sustainable Development (Reference to ADS Chapter 200), dated October 4, 2000, "Sustainable development is characterized by economic and social growth that does not exhaust the resources of a host country...Development is 'sustainable' when it permanently enhances the capacity of a society to improve its quality of life." Community agreements should clearly define a maintenance plan to ensure that infrastructure projects continue to function as intended.

However, none of the 511 infrastructure projects provided under the program included maintenance plans to help ensure that the projects continued to function as intended and provide lasting benefits to communities. Neither the agreements between DEVIDA and the communities nor the subcontracts between Chemonics and its sub-contractors require that such maintenance plans be developed. USAID/Peru itself focused on other priorities and overlooked the need to include maintenance plans in the agreements with the communities.

Without regular maintenance, infrastructure projects may experience failures. For example, the community of Ricardo Palma received a potable water system under the program at a cost of \$77,516. During our site visit, we noted that the system was not working because the system was clogged with debris. The community had not maintained the water system because they had not received any maintenance plans or training on how to maintain the water system.



Photo taken by an OIG auditor on August 31, 2005 of a community water tap in Ricardo Palma, Peru. The water system in Ricardo Palma was not functioning at the time of our visit.

Recommendation No 10: We recommend 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.

Evaluation of Management Comments – In response to Recommendation No. 10, USAID/Peru mentioned that all future infrastructure work will include an implementation plan for a community maintenance committee, and the contractor will be responsible for the organization and training of this committee. The deliverable under these sub-contracts will be a viable maintenance plan that the community agrees to implement. A sub-contract with a local NGO has been in place since June 1, 2005, and its scope of work includes the training and implementation of the maintenance committees. The community shall assume responsibility for the sustainability of the committee and the infrastructure once the infrastructure work is officially transferred to the community. An Alternative Development team member is now specifically charged with following up on the maintenance committees and maintenance plans.

Furthermore, the Mission stated that the potable water system in Ricardo Palma has been repaired and is currently functioning.

Based on the Mission's response, a management decision has been reached. Determination of final action will be made by M/CFO/APC.

Were USAID/Peru's Alternative Development Program activities managed in an efficient manner?

USAID/Peru's ADP activities were not managed in an efficient manner. The sections below describe cases where Chemonics continued to provide benefits to communities that had stopped complying with their eradication agreements and also describe a need to limit benefits to communities that have not yet eradicated their coca, a need to bring the benefits provided to communities into a more reasonable relationship with the amount of coca eradicated by the communities, and a need to better control administrative costs associated with the program.

Benefits to Non-Compliant Communities Were Not Suspended

Summary: According to the contract between USAID/Peru and Chemonics International, Inc., "the contractor would oversee the implementation of activities and suspend activities and notify USAID/Peru when communities were not compliant." Through various written communications with Chemonics, USAID/Peru had requested Chemonics to suspend activities upon notice that communities were non-compliant. However, we noted several cases where benefits (projects) had not been suspended for communities that were determined non-compliant. Moreover, Chemonics continued to enter into sub agreements to provide benefits to the communities for periods of three to nine months after the communities were determined non-compliant. Benefits provided to communities after they were determined non-compliant totaled \$225,037, according to information provided by Chemonics. This occurred because Chemonics hoped to persuade the non-compliant communities to reverse their

decisions and begin to comply again with their voluntary eradication agreements, and also because of a lack of coordination and communication between the contractor and its subcontractors. As a result, \$225,037 of U.S. Government funds were spent for ineligible purposes.

Under the Alternative Development Program, the contractors, together with the communities, identified immediate and short-term development activities that were included as benefits under the agreement to voluntarily eradicate coca. The benefits provided under these agreements included a small upfront payment, income-generating substitute crops, and community infrastructure. According to the contract between USAID/Peru and Chemonics International, Inc., the contractor would oversee the implementation of activities and suspend activities and notify USAID/Peru when communities were not compliant (communities were determined non-compliant when they rejected the voluntary eradication program by failing to meet eradication targets established in the community agreements). USAID/Peru had requested in writing that Chemonics suspend activities upon notice that the communities had become non-compliant.

However, we noted several cases where benefits (projects) had not been suspended for communities that were determined to be non-compliant. Out of the 24 communities involved in the project that were determined to be non-compliant, 13 continued to receive benefits for an additional one to eleven months. Moreover, Chemonics continued to enter into new sub-agreements to provide benefits to the communities even after the communities were determined non-compliant. Benefits provided to communities after they were determined to be non-compliant total \$225,037, according to information provided by Chemonics.

Chemonics was reluctant to terminate the benefits because they had hoped to reverse the decisions made by communities that had opted to reject the voluntary eradication program. They were not successful, but continued to fund the projects for several months after the community rejected the program. A lack of coordination and communication between Chemonics and its subcontractors also contributed to this situation. As a result, \$225,037 of U.S. government funds were spent for ineligible purposes.

Recommendation No. 11: We recommend that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$225,037 and recover from Chemonics International, Inc. the amounts determined to be unallowable.

Evaluation of Management Comments – In response to this finding and recommendation, USAID/Peru stated that investigations into the matter revealed that (1) Chemonics did incur some costs in communities that were non-compliant but these costs related to closeout activities or final attempts to persuade communities to begin complying with their eradication agreements and (2) Chemonics' accounting system sometimes allocated costs to non-compliant contributions based on pre-determined percentages even though no costs were actually being incurred in those communities.

Regarding the first point, we do not agree that the only costs incurred in non-compliant communities were closeout costs or final attempts to persuade communities to comply with their agreements. This assertion is contradicted by the fact that Chemonics entered

into new subcontracts to provide benefits to communities after they became non-compliant. Examples follow:

Community	New Sub-Contracts After Communities Became Non-Compliant	
	Infrastructure Activities	Productive Activities
Sevite Baja		\$332
Miraflores		\$11,627
Pampa Aurora		\$11,627
Paterine		\$5,823
Porvenir		\$5,425
Quillabamba		\$5,425
San Jose		\$8,927
Santa Rosa De Lima		\$5,823
Paquichari		\$2,591
Quintiarina Alta	\$18,523	\$5,425
Totals	\$18,523	\$63,025

The second point raised by the Mission, namely that Chemonics' accounting system includes incorrect information, may be correct. If the Mission determines that the information in the system was incorrect, then this should be reflected in the Mission's management decision on Recommendation No. 11.

A management decision for Recommendation No. 11 can be recorded when the contracting officer determines the amount, if any, to be recovered from Chemonics.

Benefits Should Be Limited Until Coca Is Completely Eradicated

Summary: The program provided benefits to the communities immediately after signing the agreements with the communities, even though there was no assurance that communities would comply with the agreements. As of August 31, 2004, the program invested \$1.6 million in communities that later rejected the program and decided not to voluntarily eradicate their coca. It would be more prudent to limit benefits at the outset to limit the risk of spending too much in communities that later decide not to comply with their voluntary eradication agreements. By providing the benefits immediately upon signing an agreement with the communities, the program was able to quickly establish credibility with the affected communities, and, as a result, encourage or entice other communities to participate in the program. However, not limiting the benefits to the communities until they have completely eradicated their coca fields has resulted in \$1.6 million of U.S. Government funds spent for 24 communities that have rejected the program.

The ADP program worked with community leaders and potential program beneficiaries to encourage communities to commit to voluntary coca eradication. Once the communities signed an agreement to voluntarily eradicate their coca, the program entered into local sub-contracts and grants to implement the agreed-to-activities stipulated in the agreements with communities. These activities included construction of

social and economic infrastructure, and technical assistance to develop sustainable economic activities as alternatives to coca production. It would be prudent to limit benefits at the onset of signing agreements with the communities to avoid the risk of spending too much on a community that may reject the program.

The program provided these benefits to the communities immediately after communities signed voluntary eradication agreements, even though there was no assurance that communities would comply with the agreements by actually eradicating their coca. In fact, as of August 31, 2005, the program invested \$1.6 million in 24 communities that ultimately rejected the program and decided not to voluntarily eradicate their coca.

By providing the benefits immediately upon signing an agreement with the communities, the program was able to quickly establish credibility with the affected communities, and as a result, encourage or entice other communities to participate in the program. However, not limiting the benefits to the communities until they have completely eradicated their coca fields has resulted in \$1.6 million of U.S. Government funds being spent in 24 communities that have rejected the program.

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

Evaluation of Management Comments – USAID/Peru generally agreed with this recommendation; however, the Mission stated that, as the program moves into more “hard-core” areas (i.e. communities that depend on coca for a larger portion of their overall income), where there is much lower level of trust, USAID must retain the flexibility to allow benefits to be provided in a phased manner, as there will be communities that only sign up for the program under these conditions.

A management decision for Recommendation No. 12 can be recorded when USAID/Peru develops a firm plan of action with target dates for implementing the recommendation.

Cost per Hectare Was High

Summary: The planned cost per hectare of coca eradicated under the second contract with Chemonics was \$2,187. Chemonics now considers that a cost of \$2,000 per hectare would be reasonable. However, the actual cost per hectare has averaged approximately \$4,484, with a range from \$269 to \$250,629 per hectare. The cost per hectare was high because of an ineffective strategy for targeting communities with large amounts of coca. Also, the program did not establish a standard set of benefits or a limit on how much to spend for each community that signed the voluntary eradication agreements. The benefits provided to communities varied from one community to the other, depending on the negotiations that took place between the contractor’s negotiators and community leaders. Finally, the ADP program did not require counterpart contributions (e.g., contributions of unskilled labor, materials, etc.) from the communities that participated in the program. The high cost per hectare of coca eradicated limits the program’s efficiency and ultimately its effectiveness, since fewer resources are available to pursue program objectives.

When USAID/Peru entered into its second contract with Chemonics in March 2004, the Mission expected to invest \$70 million directly in communities that signed voluntary

eradication agreements and expected to eradicate 32,000 hectares of coca during the contract period. This corresponds to a planned cost per hectare eradicated of \$2,187. Chemonics now considers that a cost of \$2,000 per hectare would be reasonable.

However, the actual cost per hectare has averaged approximately \$4,484, with a range from \$269 to \$250,629 per hectare. Below is a summary of the direct investments in the 385 communities assisted by ADP program, not including the administrative costs of the contractor:

Table 4: Direct Investments in ADP Communities

Cost per Hectare	Total Invested	Number of Communities
\$0	\$0 ⁵	7
\$269 - \$999	\$730,255	17
\$1,000 - \$5,000	\$11,800,412	117
\$5,001 - \$10,000	\$8,685,065	85
\$10,001 - \$20,000	\$8,653,440	79
\$20,001 - \$40,000	\$6,081,474	53
\$40,001 - \$100,000	\$2,136,909	20
\$100,001 - \$250,629	\$598,122	7
Total	\$38,685,677	385

The cost per hectare was higher than planned because of an ineffective strategy for targeting communities with large amounts of coca (as previously discussed above in the section beginning on page 11). Also, the program did not establish a standard set of benefits or a limit on how much to spend for each community that signed the voluntary eradication agreements. The benefits provided to communities varied from one community to the other, depending on the negotiations that took place between the contractor's negotiators and community leaders. Finally, the ADP program did not require counterpart contributions (e.g., contributions of unskilled labor, materials, etc.) from the communities that participated in the program. The Mission was under considerable pressure to show results under the ADP program, and therefore was more focused on expanding the program to new communities than on controlling costs.

The high cost per hectare of coca eradicated limits the program's efficiency and ultimately its effectiveness, since fewer resources are available to pursue program objectives. Also, inconsistencies in the benefits provided to different communities could create jealousies and dissatisfaction among communities in the program that have received fewer benefits than neighboring communities.

Recommendation No. 13: We recommend that USAID/Peru a) establish a reasonable limit on the investments made in the communities, and b) verify compliance with the limits.

Recommendation No. 14: We recommend that USAID/Peru require communities to contribute to infrastructure projects by entering into cost sharing agreements with communities.

⁵ Costs have not been incurred in these new communities that have just signed agreements to participate in the program.

Evaluation of Management Comments – In response to our draft report, USAID/Peru agreed with Recommendation No. 13 and stated that a limit of \$2,000 per hectare of coca voluntarily eradicated will be established and strictly monitored by the contractor. Accordingly, a management decision has been reached. Determination of final action will be made by M/CFO/APC.

In commenting on Recommendation No. 14, USAID/Peru agreed with the recommendation and is now requiring local governments to share costs of some infrastructure projects. A management decision will be made when the Mission has established a firm plan of action to address cost sharing contributions in future agreements with communities.

Contractor Administrative Costs Should Be Reduced

Summary: Cost-type contracts, like the contracts signed with Chemonics, involve considerable cost risk to the U.S. Government, and closer monitoring of costs by USAID is needed to mitigate this risk. To date, Chemonics has spent \$38 million for administrative costs, or 41 percent of total expenses to date. The majority of these costs were for contractor salaries and fringe benefits. USAID/Peru has expressed concern over these costs and, as a result of the Mission's concerns and also its own assessment of the level of staff it needs to implement the program, Chemonics intends to reduce the number of local staff by 39 percent from 220 to 135 in early 2006 and also plans to replace four third country nationals with local hires by the end of 2005. In addition, we noted six instances (out of a total of ten reviewed), where local staff were given additional 10 percent salary increases within three to six months after USAID had already approved initial salary increases of 5 to 25 percent. The additional increases were given for reasons that were not reasonable in USAID/Peru's opinion or in ours. As a result, we are classifying the \$2,487 spent on these salary increases as ineligible costs. Both Chemonics and the Mission were preoccupied demonstrating results under the program instead of controlling costs. As a result, the efficiency of the ADP program was impaired.

While USAID operating policies and procedures in the ADS do not specifically require USAID missions to monitor the efficiency of program operations, this is inherent in the fiduciary duty that USAID has for the funds entrusted to it. Cost-type contracts, like the contracts signed with Chemonics, involve considerable cost risk to the U.S. Government, and closer monitoring of costs by USAID is needed to mitigate this risk.

To date, of the \$93 million spent by Chemonics under both ADP program contracts, Chemonics administrative costs absorbed approximately 41 percent of contract expenditures. That is, of the \$93 million spent so far, approximately \$38 million was spent on administrative costs. The following table provides more detailed information on how the \$93 million was spent:

Table 5: Total Contract Expenses as of August 31, 2005

Category	Expenditures Under Contract I	Expenditures Under Contract II	Total Expenditures Contract I and II
Supervisory and Administrative Cost			
Home and Field Office Expense	\$8,618,027	\$14,669,436	\$23,287,463
Monitoring and Evaluation Cost	1,627,719	1,427,810	3,055,529
Indirect Costs (G&A, Overhead)	4,372,222	4,734,623	9,106,845
Fees	1,946,309	783,230	2,729,539
Subtotal	\$16,564,277	\$21,615,099	\$38,179,376
Direct Benefits			
Infrastructure Projects	14,240,778	12,162,298	26,403,076
Productive Projects	7,929,989	4,123,648	12,053,637
Bonus to Communities	4,305,723	1,060,345	5,366,068
Environmental Management	-	73,358	73,358
Policy Support	343,755	11,301	355,056
Communications	1,884,774	1,704,961	3,589,735
Other Subcontracts	4,063,831	3,359,564	7,423,395
Subtotal	\$32,768,850	\$22,495,475	\$55,264,325
Total	\$49,333,127	\$44,110,574	\$93,443,701

The majority of the administrative costs consisted of salaries and fringe benefits. Chemonics's staffing structure included four U.S. hires, four Third Country Nationals, and 220 local hires. The Mission has expressed concern over the high costs associated with salaries and benefits, specifically with respect to the justification for hiring third country nationals instead of local hires for some positions and the justification for the size of Chemonics' Lima office. In evaluating Chemonics' performance to calculate the amount of award fee to be paid to Chemonics at the end of the first contract year, USAID/Peru did not award Chemonics any points for cost control. As a result of the Mission's concerns and also its own assessment of the level of staff it needs to implement the program, Chemonics intends to reduce the number of local staff by 39 percent from 220 to 135 in early 2006 and also plans to replace four third country nationals with local hires by the end of 2005.

In addition, we noted six instances (out of a total of ten reviewed), where local staff were given additional 10 percent salary increases within two to seven months after USAID had already approved initial salary increases of 5 to 25 percent. The additional increases were given for reasons that were not reasonable in USAID/Peru's opinion or in ours. For example, several individuals were given salary increases because of a change in their responsibilities just months after USAID/Peru had already granted increases for changes in responsibilities and other factors. As a result, we are classifying the \$2,487 spent on these salary increases as ineligible costs.

The administrative costs associated with the ADP program were not properly controlled, in our opinion, because both Chemonics and the Mission were preoccupied demonstrating results under the program instead of controlling costs. The absence of any discussion of the need to monitor the efficiency of program operations in the ADS may have been a contributing factor as well.

Although Chemonics had already decided to reduce its number of employees, since no analysis was performed by USAID/Peru to determine correct personnel levels or salaries, USAID still does not have reasonable assurance that planned changes will be sufficient to ensure efficient program operation.

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.

Recommendation No. 16: We recommend 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.

Evaluation of Management Comments – In response to our draft report, USAID/Peru agreed with Recommendation No. 15. A management decision will be recorded for this recommendation when the Mission develops a firm plan of action, with target dates, for implementing the recommendation.

In commenting on Recommendation No. 16, USAID/Peru agreed with the recommendation and will pursue the issue with the contractor. A management decision will be made for Recommendation No. 16 upon contracting officer's determination of the amount, if any, to be recovered from Chemonics.

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 August 22 to September 8, 2005, at USAID/Peru, Chemonics International, Inc., various contractor regional offices, governmental offices, and selected program communities.

As part of its fiscal year 2005 audit plan, the Regional Inspector General/San Salvador performed this audit to answer the following questions: (1) Were USAID/Peru's Alternative Development Program activities on schedule to achieve planned sustainable results? (2) Were USAID/Peru's Alternative Development Program activities managed in an efficient manner?

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.

Out of a total 385 communities, we judgmentally selected 10 communities to conduct site visits. We focused our selection on communities that had large amounts of hectares of coca eradicated. 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. The 10 communities included Achinamiza, Ricardo Palma, Llucanayacu, Banda de Chazuta, Shepte, Miraflores, Dos Unidos, Mojarras, Santa Ines, and Alto El Sol, all within the region of Tocache (one of the four main regions of the program). We were unable to conduct site visits in the other three main regions due to security concerns. In these 10 communities, we observed all 10 infrastructure projects and 8 agricultural projects in those communities to determine if the projects were functioning as intended. Total infrastructure projects for the program were 511. The 10 communities visited included 1,581 families out of a total of 32,756 families participating in the program as of August 31, 2005.

The audit primarily covered the short-term community support activities managed primarily through two contracts with Chemonics International, Inc. The first contract was signed in October 2002 for \$50 million for 18 months, and the follow-up contract was signed in March 2004 for \$102 million for four years (from March 2004 through September 2007). As of August 31, 2005, \$93 million had been spent on both contracts. Interviews were conducted with mission officials, Chemonics, Government of Peru officials, State Department officials, and beneficiaries. We also examined program documentation provided by these parties.

Methodology

To answer the first question described in the scope section, we traced actual results reported by Chemonics International, Inc. to supporting documentation generated from the monitoring and evaluation database developed by Chemonics. We also verified actual results with community leaders during the site visits we conducted at the 10 communities mentioned in the scope section. In addition, we reviewed USAID/Peru's performance monitoring plan, USAID/Peru's 2005 annual report, the contracts between USAID/Peru and Chemonics, Chemonics' annual report dated March 2005, Chemonics progress reports, the monitoring and evaluation system developed by Chemonics, and the award fee plan prepared by the Mission. Based on the performance monitoring plan and the contract agreement between USAID/Peru and Chemonics, we (in conjunction with Chemonics and USAID/Peru) 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, contractor officer, monitoring and evaluation specialist, and other Alternative Development Program team members. We also interviewed officials from Chemonics International, Inc., DEVIDA (Government of Peru's counter-narcotics agency), CADA (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.

To answer the second question described in the scope section above, we interviewed mission officials and Chemonics officials. For the 24 non-compliant communities reviewed, we compared the dates the communities were determined non-compliant to the dates the benefits had ceased for those communities. We also reviewed the total funds spent for those communities before and after it was determined non-compliant. For the amount spent per hectare, we compared the total benefits provided to the communities to the number of hectares eradicated in each community for all 385 communities that participated in the program. In addition, we reviewed the positions and salaries for all 8 U.S. and third country nationals and 10 local hires to determine if the salaries were reasonable.

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

November 14, 2005

MEMORANDUM

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

FROM: USAID/Peru Director, Hilda Arellano /s/

SUBJECT: Response to Draft Audit Report on Alternative Development Program

SUMMARY RESPONSE TO DRAFT AUDIT

Although the draft audit report contains many useful recommendations for strengthening the Mission's Alternative Development Program, USAID/Peru disagrees with some of the overarching conclusions of the report. As highlighted in the report, the Program could indeed have been managed more cost-effectively in its early stages. In most cases, the Mission had identified the shortcomings prior to the audit visit and has for some time been making changes in program implementation to improve efficiencies. But the more fundamental conclusion of the report, that the program is not on schedule to achieve sustainable results, is based on misconceptions of the key indicators of success of the program.

The first section of the audit report displays a table that lists the following as "Main Indicators":

1. Number of Hectares of Illicit Coca Voluntarily Eradicated
2. Number of Program Clients Who Remain Coca Free
3. Total Hectares of Illicit Coca in Peru
4. Population Involved in Coca Production

A footnote to the table states that "(t)hese were the four main performance indicators from the Alternative Development Program (ADP) and were considered by USAID/Peru and Chemonics (and us) to be the key indicators of success for the overall program." Although, as the audit report points out, the Chemonics contract does include the third and fourth indicators mentioned above as measures of success of the program, the contract does specify (page C-11) that the first two indicators above, those focusing on auto eradication, will be the primary factors on which contractor performance will be judged.

The Alternative Development Program was designed to achieve the Mission's Special Objective "Sustained Reduction of Illicit Coca Crops in **Target Areas of Peru** (emphasis added)". The ADP, with its focus on auto eradication in geographically limited areas, is just one of the three components of the overall Embassy/Peru counter-narcotics strategy. (The other major components are, of course, interdiction and programmed eradication.) The embassy-wide strategy, bringing all USG resources to bear, seeks to impact on the third and fourth, national-level indicators listed above. USAID/Peru strategic documents, in support of the overall Embassy strategy, included these indicators in our results framework, and they also appeared in the Chemonics contract.

The statistics for “Total Hectares of Illicit Coca in Peru”, along with its corollary indicator “Number of Families Involved in Coca Production” (#s 3 and 4 above), rise and fall dramatically to a great extent due to macro factors such as pressure applied to the illicit coca industry in other coca producing countries in the region (the “balloon effect”) and regional prices for coca leaf in general. USAID/Peru strives to implement its ADP towards achievement of the Mission’s SPO and ultimately the Embassy-wide objectives but, in light of the importance of the other major components of the overall embassy counter-narcotics program, we have come to realize that our impact on those higher-level objectives may be less than fully within our manageable interest. Indeed, due mainly to data quality problems (i.e. the major discrepancies between the CNC data and the UN data that was discussed in the audit report), USAID/Peru will be dropping those indicators after this year’s annual report.

The Mission does indeed consider “Number of Hectares of Illicit Coca Voluntarily Eradicated” and “Number of Program Clients Who Remain Coca Free” to be key indicators of success of the ADP. In this regard, the Program exceeded its targets for both these indicators in both CYs 2003 and 2004. For CY 2005, the program has already exceeded its target for number of coca free program clients (30,455 vs target of 30,000). As of November 7, 2005, the program has achieved 1,062 hectares of coca voluntarily eradicated towards its CY target of 3000. The Mission is relatively confident that the final result will fall between 2,500 and 3,000. The Mission requests that these data be taken into account to reevaluate the conclusion of the draft report.

Based on this record, the Mission considers the Alternative Development Program to be essentially on schedule to achieve planned sustainable results. With some refinements (i.e. the possible addition of a component of “post-programmed eradication alternative development” as outlined below to complement the voluntary eradication program), the Mission looks forward to continuing successful implementation of the Program through the end of the current strategy period (end FY 2007).

The following are the Mission’s comments on, and responses to, the 16 specific recommendations of the draft audit report. In many cases we agree with the recommendations and outline the steps we are taking (or in some instances had already taken) to resolve the issues. In some cases we agree with the audit team’s characterization of the ideal solution to a problem (e.g. the recommendation to limit benefits to communities until the communities completely eradicate their coca), but disagree on the feasibility of the recommended solution or the timetable for its implementation.

SPECIFIC COMMENTS ON AUDIT RECOMMENDATIONS

Recommendation No. 1: We recommend 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.

Discussion: The Mission agrees with the audit finding that more effective host government support would improve ADP project performance. As is the case with many USAID programs around the world, one of our greatest challenges is to increase host country “ownership” of the development agenda. The situation for USAID/Peru is further complicated by the fact that the alternative development program is just one component of a major overarching Embassy-wide counter-narcotics program.

Given the cross-agency nature of the USG counter-narcotics program, USAID is just one of several USG agencies at Post that struggle on a daily basis to try to improve GOP commitment and support for the various components of the program. The Ambassador is well aware of the various shortcomings in terms of cooperation and support received from the Peruvian government at all levels, and regularly utilizes his own communications channels to the highest levels of the GOP to try to improve performance. Still, for all the reasons cited in the audit report, there could be vast improvement in support forthcoming from the host government.

Action: USAID/Peru and NAS are moving forward with a joint plan to leverage increased GOP support in the areas where both programs are working, and the plan has already resulted in increased government commitments in two of the three areas (security and increased eradication pressure) specifically mentioned in the audit report.

The USAID/NAS plan calls for much closer coordination between NAS' support for GOP programmed eradication efforts and USAID's voluntary eradication program. In a marked change from past practices, USAID will offer alternative development programs to communities that have undergone programmed eradication and are willing to sign agreements not to replant their coca. By providing viable licit options for these communities, this new strategy will allow the GOP to break the cycle of communities repeatedly undergoing programmed eradication and then simply replanting. It also allows the government to soften the image of the programmed eradication program as not providing any alternatives. From the USG side, this new approach is providing an opportunity to leverage increased GOP support for the AD program.

Given the GOP's interest in USAID agreeing to provide post-eradication alternative development programs for the reason cited above, USAID and NAS recently and in various forums jointly presented the plan to Devida and CORAH (the GOP entity that carries out programmed eradication), to make clear the concrete actions and commitments the GOP would need to take for the USG to agree to implement the plan. As outlined below, the various GOP entities have accepted the plan, have agreed to the necessary commitments, and are proceeding with concrete actions.

The audit report discusses the need for stronger, more responsive state presence in the coca-producing regions and improved security, and in response to the joint plan the GOP is already taking major steps in that direction. The USAID/NAS plan called for the first post-eradication alternative development intervention to take place in Pizana/Polvera (a hard-core coca-growing area where a major programmed eradication campaign was just completed). But USAID/NAS informed the GOP that, if the intervention is to take place, it must be the GOP itself that takes the lead in the difficult (and even somewhat dangerous) work of 1) advising local government leaders in that area that they will not be allowed to replant; and 2) convincing them that they should agree to participate in the AD program under "no replanting" agreements.

As a result of the united USAID/NAS front on the issue and the attractiveness of the program offered, Devida has already reacted. Regional Devida officials have begun meeting with government officials in the various communities (3 to date) in the Pizana/Polvera area, and are transmitting the agreed-upon uncompromising message to them. This is a major step forward for a GOP entity that to date has been reluctant to be the face of a tough CN message to local communities. As local

government officials begin to agree to sign up for and even lead the program in their communities (and indications are that that will happen), this could be a significant step forward for increasing the authority and prestige of government in those areas, and ultimately lead to improved security.

The audit report notes the need for increased GOP support for AD programs through stepped up programmed eradication; increasing the perceived threat and thereby driving communities to agree to participate in voluntary eradication agreements. The joint USAID/NAS plan has also leveraged increased GOP support in this area. CORAH has agreed to support the proposed post-eradication alternative development plan by returning repeatedly over the next year to re-eradicate in the Pizana/Polvora area (a major change in CORAH's usual eradication plans). This commitment to re-eradication is critically important to the success of a post-eradication alternative development program, (so that those communities become convinced that there is no alternative to a coca free community), and exactly what is needed in terms of GOP support.

The only area that is specifically mentioned in the audit report in which to date we have been unable to leverage additional GOP support and commitment is in land titling, and this case provides an excellent illustration of the limits of our power to leverage commitments. Despite great and repeated efforts over the last several years by the USAID technical office, USAID mission management, and even by the Ambassador himself on several occasions with the highest levels of the GOP, it has proved impossible to successfully rally GOP support to this effort to produce 6,000 land titles. The Mission will continue to push at all levels (indeed, the issue was raised in a briefing by the Ambassador to the Prime Minister on November 9) in order to complete this activity successfully.

Recommendation No. 2: We recommend that USAID/Peru in coordination with the State Department's Narcotics Affairs Section (NAS), CADA (Cuerpo de Asistencia para el Desarrollo Alternativo), DEVIDA (Comision 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.

Discussion: Since the initiation of the voluntary eradication program in late 2002 and through the audit period of 2004, USAID, NAS, DEVIDA and CADA have been meeting regularly to define eradication plans for both voluntary eradication and programmed eradication. In the beginning of the voluntary eradication program, the eradication plan was specifically designed not to target or favor communities with high concentrations of coca for several reasons. One reason was so as not to create a perverse incentive for communities to grow more coca. A goal was to include as many communities as possible in the coca-growing regions that had coca, even those that had lesser amounts than others, so as not to create the perception that the USG and the Government of Peru were rewarding communities that had been growing large amounts of illicit coca and ignoring communities that had chosen a licit life-style. Further, political and social conditions in the coca-growing areas were such that even CORAH, the GoP's heavily police-protected programmed eradication team, could not move into hard-core communities to eradicate because of the social unrest that analysts agreed would follow. Eradication, voluntary or otherwise, was just too de-stabilizing for an already unpopular government and too risky for a shaky democracy.

And while the program was not as efficient or cost-effective as it might have been had these limiting circumstances not existed, the first phase did achieve some major successes. By going into communities with even a small amount of coca and getting the population to sign the voluntary eradication agreement, the program eroded the popular base of support that the cocaleros had been enjoying and exploiting for years. The first phase also consolidated areas around major USG investments, such as the Fernando Belaunde Terry (FBT) highway, and went a long way to making these areas largely coca free.

Even in this difficult context, USAID/Peru has continuously committed to making the program as efficient as possible. Starting in late calendar year 2004, the program shifted to operating on a multi-community basis and has limited investment in communities to \$2,000 per hectare eradicated.

As for measuring coca and verifying that it is eradicated, the audit is correct in describing the processes as “time-consuming”. Unfortunately, the ADP had no choice in the matter of phasing coca eradication and its measurement. President Toledo signed Supreme Decree 044 in April, 2003, stipulating that voluntary eradication must be “gradual and concerted”. Thus, eradication and its verification had to be done in stages, making it operationally cumbersome for the contractor and for CADA. On the other hand, there were positive aspects to the multiple visits that CADA and the contractor paid to the communities.

When the voluntary eradication program began Devida, the GoP agency responsible for reaching agreements, had no credibility in the field. Local populations, rightly or wrongly, believed that the GoP would welch on any promises made to deliver benefits under the program, reflecting a well-documented national tendency to distrust government entities. Local populations echoed the narco-led mantra that: “alternative development is a failure.” By phasing voluntary eradication and the subsequent investment in communities, the program succeeded in demonstrating its commitment to the community. The gradual flow of benefits to the communities was an important step in building credibility with populations that felt that they had been deceived in the past. This said, the Alternative Development Program goes to considerable efforts to encourage communities to eradicate their coca all at once, an option that many communities choose, requiring that CADA return only once for verification.

Action: As the draft audit report points out, targeting communities for coca eradication and verifying its eradication is cumbersome and USAID/Peru, NAS, CADA and CORAH must continuously refine their methodologies so that voluntary eradication and programmed eradication are using USG funds as efficiently as possible. As of FY 2003, there is an inter-institutional committee composed of the above-mentioned agencies that meets throughout the year to target areas for eradication, monitor progress and address challenges that invariably arise in this complex environment. For 2006, USAID and NAS plan to pursue new methodologies for targeting coca for the voluntary eradication program. First, NAS has new surveillance capability in a C26 airplane equipped with a camera and Global Position System (GPS). NAS will perform overflights in areas suspected to have dense coca, map the coca and give the information to USAID, so that USAID’s contractor can approach the local authorities and the communities about the voluntary eradication program. Secondly, the program will procure satellite photographs, CADA will analyze them and the USAID contractor will ground-truth the analysis.

For the verification step of the voluntary eradication program, USAID, NAS, CADA and Chemonics have already initiated a more efficient and more effective methodology. When a community is ready to eradicate, CADA returns to the community and supervises the eradication as it is happening. To date in the 2005 VE program, virtually all communities have eradicated all at once, reducing to one the number of times that CADA has to return to a community.

Recommendation No. 3: We recommend that USAID/Peru require communities to eradicate all of their coca at one time, not in phases.

Action: USAID/PERU agrees with the audit finding that it would be more efficient and cost effective for communities to eradicate their coca at one time. As explained in the discussion above, the Supreme Decree signed by President Toledo in April, 2003, does not allow the program to insist on eradication of all of the coca in communities at once - - it must be gradual and concerted. But communities may choose to eradicate at one time and USAID, through its contractor, will continue to encourage communities to do so.⁶

Recommendation No. 4: We recommend 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.

Action: The Award Fee Plan for 2006 and 2007 will stipulate that 50 percent of the award fee pool will be assigned to meeting the eradication target and the number of clients who remain coca-free. USAID/Peru considers it too late in the calendar year to change the Award Fee Plan for 2005.

Recommendation No. 5: We recommend that USAID/Peru a) modify its contract with Chemonics International, Inc. to reflect the revised target and b) ensure that the revised target is consistent among mission documents.

Action: USAID/Peru agrees that all documents pertaining to the Alternative Development program must be consistent. The MAARD to request the contract revisions has been cleared by all pertinent USAID/Peru staff. The revised contract will be signed by the contractor in the next thirty (30) days. All other mission documents will be reviewed and revised as needed within the next 60 days.

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

Action: USAID/Peru has established a contract (not program) target of 2,500 hectares for 2006 and 500 hectares for 2007 for the present contract. The contract end date is September 2007, which, in the final year of the contract, gives the contractor only 9 months to achieve the target and close out the program, as well as

⁶ In fact, in the most recent series of multi-community agreements, communities are choosing to eradicate all at once, demonstrating a confidence in the program that did not previously exist.

implement the infrastructure projects and initiate productive activities. The targets are consistent with an efficient implementation, given the level of funding available through the end of the contract.

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

Discussion: The Mission notes that the headline title of this section of the draft audit report is “Cash Payments Were Susceptible to Fraud...”, yet the body of the report fails to mention the good news. Although significant funds were disbursed in cash payments to a large number of beneficiaries under very difficult field conditions, there have been no indications of fraud. USAID/Peru agrees that any cash payment program in the coca-growing regions is susceptible to fraud, but the reality is that the Mission and the contractor took great pains to ensure that fraud did not occur. Indeed, the audit team spent significant field time tracking down randomly selected program beneficiaries and, to our knowledge, no fraud was uncovered.

The audit report quotes CADA officials as saying that “...ironically, farmers in several communities began to grow more coca in order to become eligible for cash payments.” It would seem illogical that farmers would go to the trouble to plant coca fields in order to become eligible for the payments, since it was widely known in the coca valleys that all community members, coca-growing or not, would receive the same payment under the program.

Action: USAID/Peru agrees with the conclusion of the draft audit report that the resources expended for cash payments could better promote sustainable income generation if invested in economic infrastructure projects or development of licit productive activities. Based on the Mission’s ongoing reservations regarding the development value of the bonuses, in June, 2005 the contractor was requested to perform an assessment, through extensive field surveys in beneficiary communities, of the impact of these payments. Overall results were mixed, although the surveys did show that many PDA clients (41%) used the bonus to invest in their farms, clearly achieving a developmental impact.

A more worrisome finding of the surveys, in light of the goal to transition out of such payments, was that nearly half the PDA participants said they would not have signed the agreement without the bonus. Abruptly removing it from the benefit package might affect the program’s ability to meet its objectives in the short term.

As recommended in the audit report, USAID/Peru and its contractor are in the process of trying to phase out the bonus payment so that funds budgeted for the payments could instead be invested in sustainable development activities, but we also recognize the value of the payment as a catalyst to convince families to take that first step towards a licit life style. The Mission must retain the flexibility to allow the possible use of the bonus payment in the overall development package, while ensuring that the contractor do everything possible to phase out the payment so that in the next stage of USAID/Peru’s Alternative Development Program a bonus payment will not be part of the package.

Recommendation No 8: We recommend 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 International, Inc. and the Government of Peru's counter-narcotics agency (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.

Action: USAID/Peru agrees with this recommendation and as of January 2005, had already implemented a new standard agreement with the communities that states that all infrastructure projects are subject to an environmental assessment prior to implementation. USAID/Peru has also provided the contractor with explicit guidance as to what kinds of projects are allowable in these negotiations. A technical information sheet (ficha) for every possible type of infrastructure project is included in the negotiation packet and includes information as to type and scope of the project, program and community commitments under the agreement, scheduling and any conditions precedents needed to initiate the project.

Recommendation No 9: We recommend that USAID/Peru ensure 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.

Discussion: USAID/Peru agrees with this recommendation and, in January, 2005, introduced a new agreement to be used in negotiations with the communities. The agreement includes guidelines/checklists for the community liaison workers to use when prioritizing infrastructure projects. There are six types of projects that can be negotiated in the agreement. They include: (i) educational infrastructure, (ii) water and sewage, (iii) health infrastructure (iv) economic infrastructure (v) electrification and (vi) road rehabilitation and bridge construction.

If a community or group of communities requests a project that is not part of the approved list, the contractor must receive USAID/Peru approval prior to negotiating with the communities.

Action: USAID/Peru agrees with this recommendation and has implemented a new community negotiation process that will ensure that only infrastructure projects that contribute to the program goal of generating licit economic activities will be implemented under the program.

Recommendation No 10: We recommend 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.

Discussion: Given that the Alternative Development Program, almost by definition, operates in communities that have a near-complete lack of government presence, the process of creating and enforcing maintenance agreements at the community level could be an entire sub-activity of the program. Notwithstanding the difficulties, in each of the scopes of work for sub-contractors and sub-grantees of the Chemonics contract, the sub-contractor or sub-grantee is required to initiate and train a community maintenance committee for the infrastructure project that is being implemented. Chemonics has implemented almost 500 infrastructure projects in the last two years. These projects are scattered throughout a wide, complex and difficult geographic area, many reachable only by foot. Because of the sheer quantity of

work, the maintenance committees and their plans took a back seat to getting the works completed in a timely manner. In addition, competing demands on field staff required them to move into new communities to initiate voluntary eradication to meet the new year's goals, leaving little time for them to return to communities that had already eradicated to make sure that the maintenance committees were operational and plans were in place. This was a short-coming of the 2004 work plan and the supervision of the sub-contractors and the sub-grantees.

Action: All future infrastructure work will include an implementation plan for a community maintenance committee, and the contractor will be responsible for the organization and training of said committee. The deliverable under these sub-contracts will be a viable maintenance plan that the community agrees to implement. A sub-contract with a local NGO has been in place since June 1 2005, and its scope of work includes the training and implementation of the maintenance committees. The community shall assume responsibility for the sustainability of the committee and the infrastructure once the infrastructure work is officially transferred to the community. An Alternative Development team member is now specifically charged with following up on the maintenance committees and maintenance plans.

The potable water system in Ricardo Palma has been repaired and is currently functioning.

Recommendation No. 11: We recommend that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$225,037 and recover from Chemonics International, Inc. the amounts determined to be unallowable.

Discussion: The funds reported as disbursed to communities after they had rejected the PDA do not pertain to monies directly channeled to those communities. Rather, because of the nature of the implementation instruments used by the Alternative Development Program — grants and subcontracts with Peruvian organizations to provide the goods and/or services required to execute agreed upon projects — funds are disbursed directly to those organizations in accordance with the terms of their respective grants and subcontracts. Funds are not directly disbursed to beneficiary communities.

Further, in the accounting system, these implementation instruments are linked to the specific communities they have been designed to support. Each community included in the grant or subcontract is assigned a certain weight within the total value of the instrument depending on the number of hectares being attended (i.e., for a productive activity) or project being implemented (i.e., infrastructure). For example, if 10 communities are part of a single grant, for every disbursement of \$100, each community may be assigned \$10. If one of these communities rejects the program subsequent to initiation of the activity, the status of this individual community within the monitoring and evaluation system is changed to “frozen” so that the respective allocations are not made to the community rejecting the Alternative Development Program. In some cases following rejection by a community, the system was not immediately updated for a variety of factors, including continued socialization efforts with the community to convince them to switch back to supporting the Alternative Development Program. As a consequence, there were cases such as those identified in the audit report where the accounting system continued to assign disbursement values to a community after it had rejected the Alternative Development Program. However, this “tracking” of funds is at the system level; it

does not reflect disbursement of funds to, or direct support to communities after they reject the program.

Finally, after the communities in question rejected the Alternative Development Program, payments under the respective implementation instruments were still due to the grantees and/or subcontractors for work completed in those communities prior to their rejection of the program.

In summary, based on the above explanation as well as the community-specific information provided in the attached table, we are confident that Alternative Development Program funds were not spent on projects in non-compliant communities once their rejection of the program became known. Any appearance of inappropriate use of Alternative Development funds in those communities is the result of (a) the method in which community information is aggregated in the accounting system, including the delay, in some cases, of classifying communities as "paralyzed" because socialization efforts were continued in an effort to get them to support the program, and (b) disbursements being made to pay for costs incurred by grantees or subcontractors for work undertaken prior to those communities rejecting the program.

Action: The investigation into the matter of funds that appeared to have been spent on behalf of non-compliant communities revealed, as is explained above, that to the extent expenditures took place as part of the normal service/reimbursement process, they: 1) related to satisfying accounts for works accomplished prior to the non-compliant status, or 2) related to the "shutting down" process wherein final attempts were made to get communities to change their mind (socialization costs, not benefits). Other apparent expenditures related to how the Chemonics accounting system aggregated and/or prorated fixed and higher level expenses. Given these findings, the Mission concludes that there do not appear to be \$225,037 of unallowable costs. For the first category, it would not have been prudent or acceptable from either the business or local relations viewpoint to void these kinds of payment obligations. For the second category, clear standards will be confirmed for segregating and limiting socialization, as opposed to benefits, expenses. Finally, the cost accounting system will be reviewed with the objective of tagging or backing out upper level cost allocations formerly associated with non-compliant, hence non-participating, communities. The overall objective will be to avoid this confusion in future.

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

Discussion: In the first phase of the program, benefits were initiated immediately after the communities signed their voluntary eradication agreements, primarily to demonstrate the commitment of the program to follow through with the promised investments in the communities.

Fair or not, there was widespread belief in the coca-growing areas that alternative development programs over the years had been a failure; there was a great lack of trust and little social capital for the program to leverage. Moreover, because the eradication methodology was phased (as outlined above, the law prohibits the Alternative Development Program from demanding that coca be eradicated all at once), USAID/Peru had built-in check points so that if eradication was not taking place, infrastructure work could be stopped. The thinking was that if the population

stopped eradicating their coca and the infrastructure work was then stopped, a partially-finished school or multi-purpose room could be a tool for the people who had eradicated their coca to apply social pressure to those who defaulted on the agreement. There were, in fact, several communities in which works were paralyzed and then resumed when pressure was put on those community members who were not eradicating their coca.

Because the Alternative Development Program has now implemented almost 500 infrastructure projects in the last two years, it has gained the trust of hundreds of communities in the area. As a sign of the trust that has been earned, in the first set of multi-communities to sign the voluntary eradication agreement with DEVIDA in 2005, no benefits were initiated until after all the coca was eradicated.

Action: The Mission agrees that limiting benefits until coca is eradicated is the ideal manner in which to implement the voluntary eradication program and, as illustrated above, we have been successfully moving towards that goal. The Mission believes that in most new communities that the Alternative Development Program will enter we **can** do business that way. However, given that the Alternative Development Program is steadily moving into more “hard core” areas (i.e. communities that depend on coca for a larger portion of their overall income) where there is a much lower level of trust for the Program, USAID/Peru must retain the flexibility to allow benefits to be provided in a phased manner as coca is eradicated, since there will be communities that only sign up for the program under these conditions.

Recommendation No. 13: We recommend that USAID/Peru a) establish a reasonable limit on the investments made in the communities and b) ensure compliance with the limits.

Action: USAID/Peru agrees with this recommendation and in May 2005 implemented a policy that limits direct investment in a community to \$2,000 per hectare of coca voluntarily eradicated. This limit is being strictly monitored by the contractor and might have to be adjusted upwards depending on the reaction of the communities and the sustainability of the eradication.

Recommendation No. 14: We recommend that USAID/Peru require communities to contribute to infrastructure projects by entering into cost sharing agreements with communities.

Discussion: USAID/Peru strongly agrees with the concept of cost sharing to promote community “ownership”, yet when the program was designed, cost sharing by the communities was not considered to be an option for several reasons. One is that the target population is one of the poorest and most marginalized in all of Peru. The very nature of these isolated, stateless, communities is the reason they are the target of the narco-traffickers. Secondly, the only real cash crop in many of these communities was coca, leaving few legitimate community resources to contribute. Thirdly, if in-kind labor for infrastructure projects were considered as cost-sharing, it would take the farmers away from tending their subsistence crops and could have further repercussions such as a decline in nutritional status of the farming family. In fact, wages for unskilled labor performed by community members were built into the program to soften the blow of the eradication of coca on a family’s income. Until PDA-supported products, such as cacao, coffee and African palm, are mature and producing income, USAID/Peru sees little opportunity to require a cost-sharing plan by the community.

On the other hand, USAID/Peru and its contractor are now working with local mayors and other elected leaders to prioritize projects that they and their constituents had identified in their Regional Development Plans and only investing in those projects if there is a counterpart contribution from the municipality.

Action: USAID/Peru agrees that cost-sharing must be integrated into the Alternative Development Program. USAID/Peru's contractor is now requiring local governments to share costs in infrastructure projects that are a part of the Regional Development Plan.

Recommendation No 15: *We recommend that USAID/Peru a) conduct a personnel assessment to determine the level of staffing required to implement the program and to determine if the salaries paid are reasonable, and b) monitor and ensure that Chemonics International, Inc. will transition its international staff as intended.*

Discussion: On a monthly basis USAID/Peru and Chemonics carefully analyze real project and implementation needs. As a way to save project funds and facilitate implementation, a decision is sometimes made to hire staff for *direct implementation* rather than subcontracting these activities. A good example of this is directly employing an engineer to supervise infrastructure projects, rather than subcontracting a firm for that same kind of work. For this reason, though the number of direct hires at a given moment might appear high, there is ample programmatic and cost justification.

The number of employees mentioned by the auditors (220) includes staff that contribute 100% of their time to the direct implementation of Alternative Development Program investments for beneficiary communities. This number has a direct correlation with the number of activities carried out by the Alternative Development Program and so, when the infrastructure component of the program slows down, the numbers of employees will decrease. Also, working with more than 379 communities (with at least 250 more being added in 2005) and providing technical assistance, inputs, and supervision of more than 37,500 hectares of crops require appropriate staffing levels to ensure that resources are being used properly and achieving intended results.

As the Alternative Development Program implementation proceeds, the number of employees will decrease as the level of activities diminish. Such a reduction in staff was always contemplated in the budget.

The reasonableness of salary levels is based on market analysis and prior experience/salary history. These are all well supported by documentation in Chemonics personnel files.

Action: USAID/Peru is working carefully with Chemonics to continuously analyze staff needs. A staff reduction plan has been established for the remaining two years of the contract.

As agreed to in the Alternative Development contract, the four expatriate positions were scheduled to transition to local professional staff by March 2006 (two years after contract award). However, in an effort to reduce costs, as well as to increase local ownership, Chemonics advanced three of these departures to December 2005. The total estimated salary savings from this 3-month change is approximately

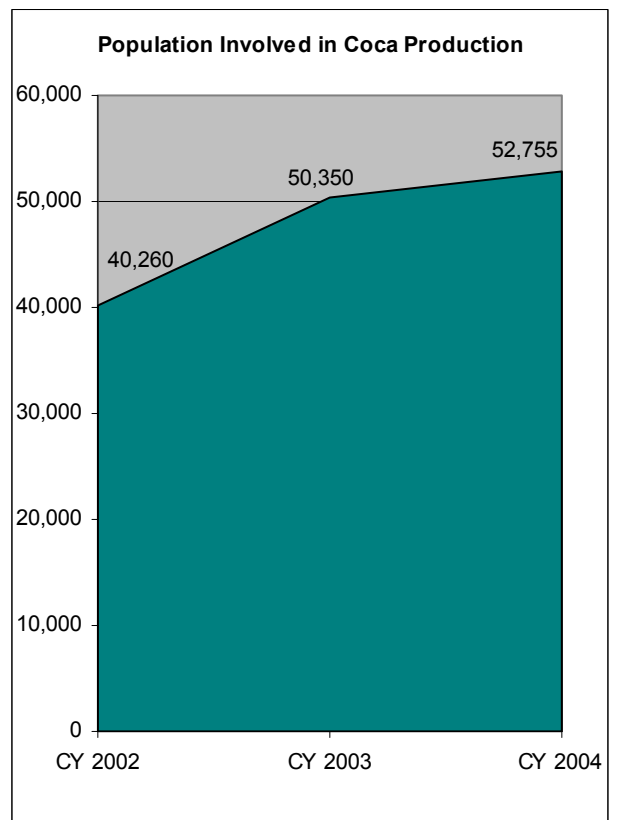
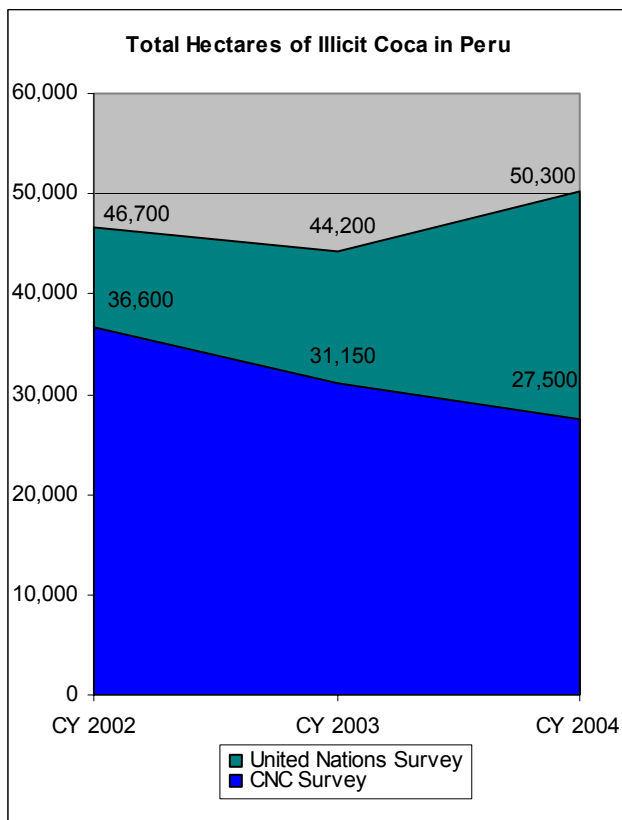
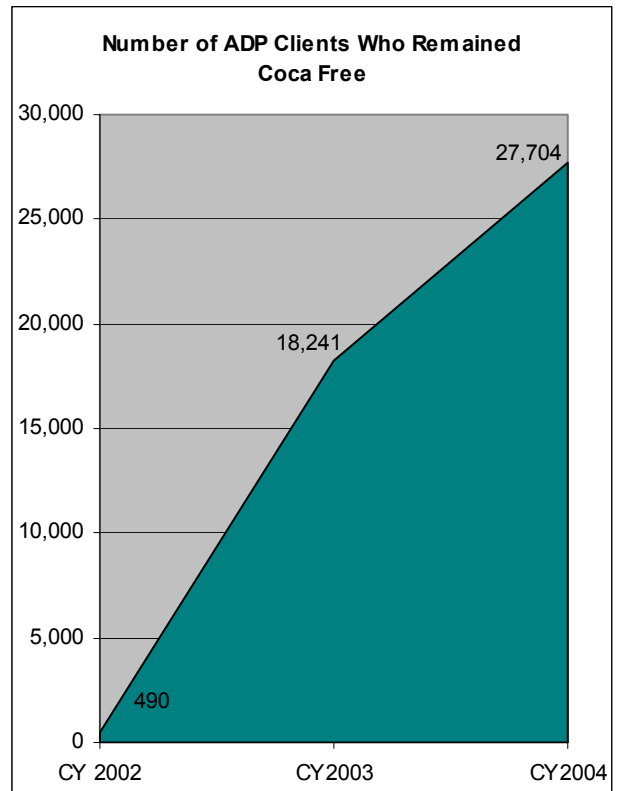
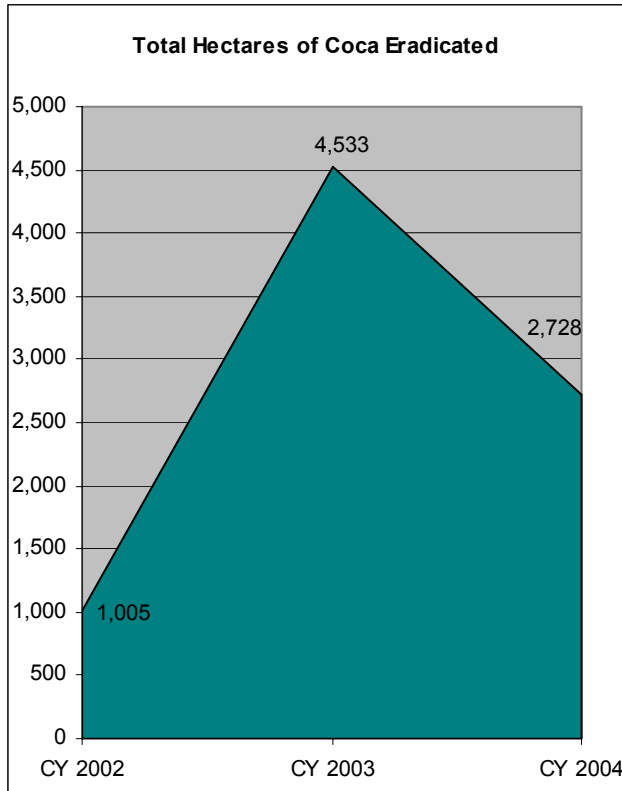
\$44,000. **The fourth ex-pat is staying on until March, 2006 at USAID/Peru's request.** The USAID/Peru Office of Environment requested that Chemonics' forestry expert stay on for three more months to help that office in its work on forestry concessions in coca-growing regions.

In 2006, two other expatriate positions will be eliminated, leaving only two expatriates in place until the end of the contract. As mentioned in the report, the six expatriates who leave the project will be replaced by Peruvian professionals already on the staff who have been mentored and trained to take over these roles.

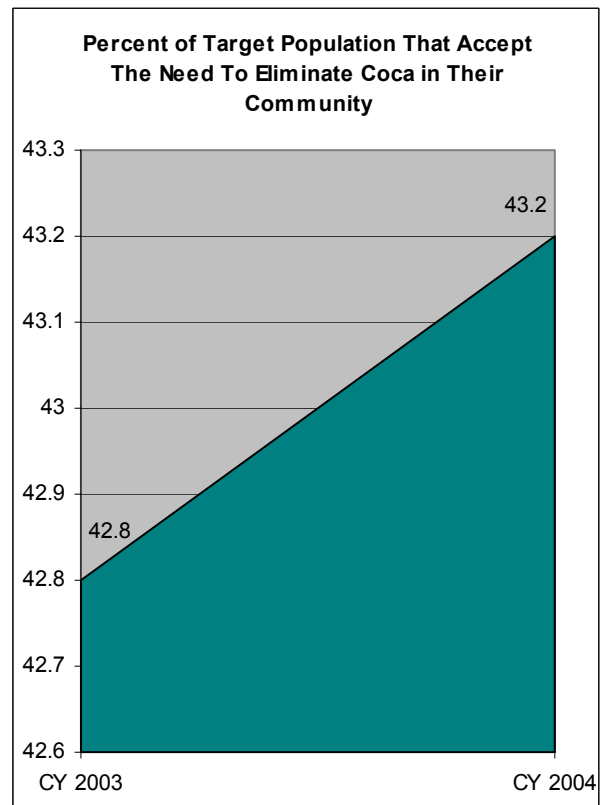
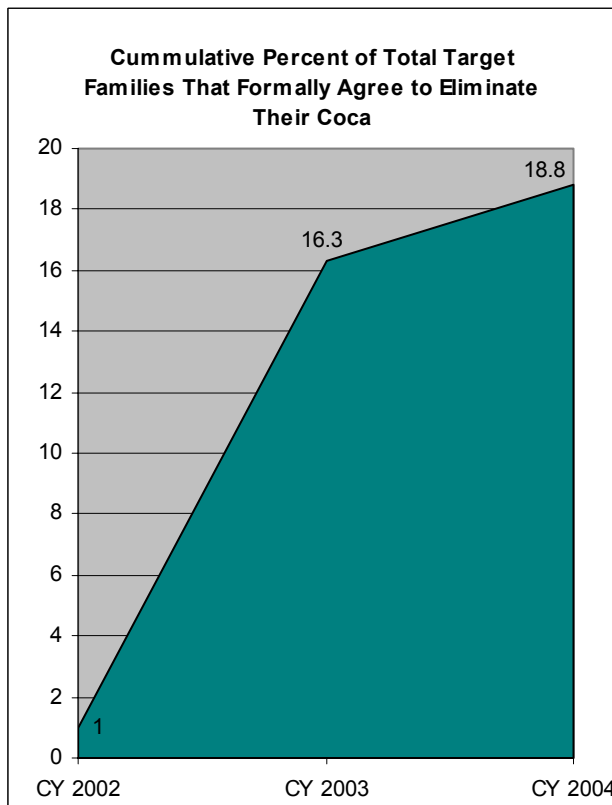
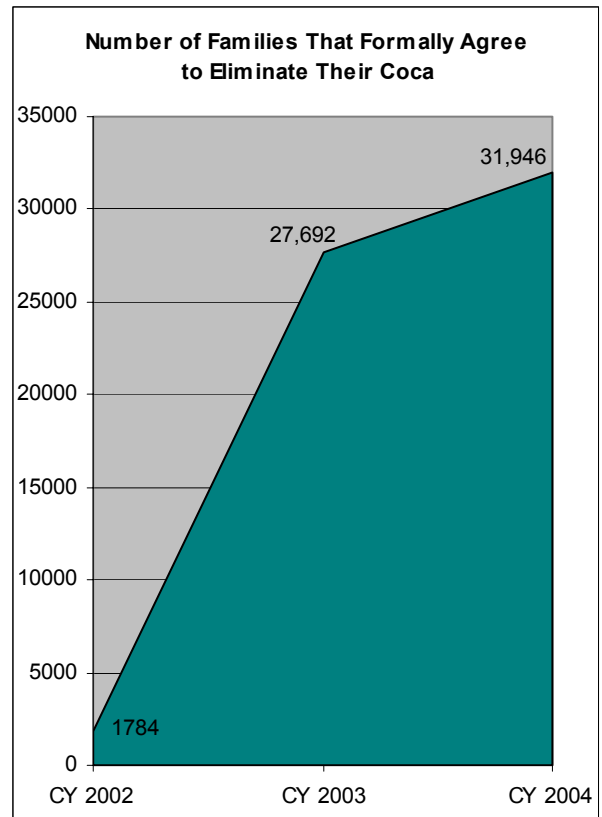
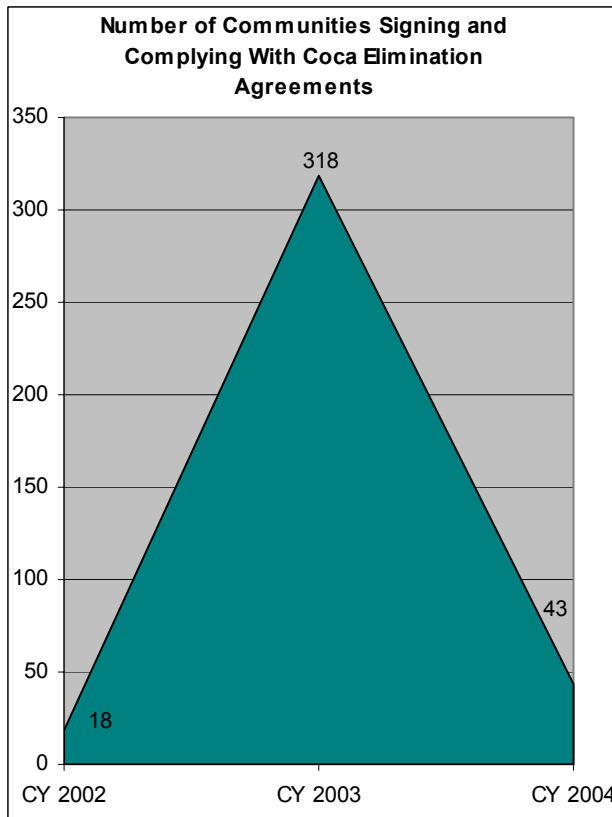
Recommendation No. 16: We recommend that USAID/Peru make a management decision with regard to the ineligible questioned costs of \$2,487 and recover from Chemonics International, Inc. the amounts determined to be unallowable.

Action: The Mission is concerned over the question of appropriate salary increases paid out by Chemonics. We will pursue the issue with them, identify any salaries that are not in compliance with Chemonics policy and/or required USAID approvals, request these salaries be adjusted, and issue a bill of collection for any excessive salary payments.

Alternative Development Program Indicators



Alternative Development Program Indicators



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