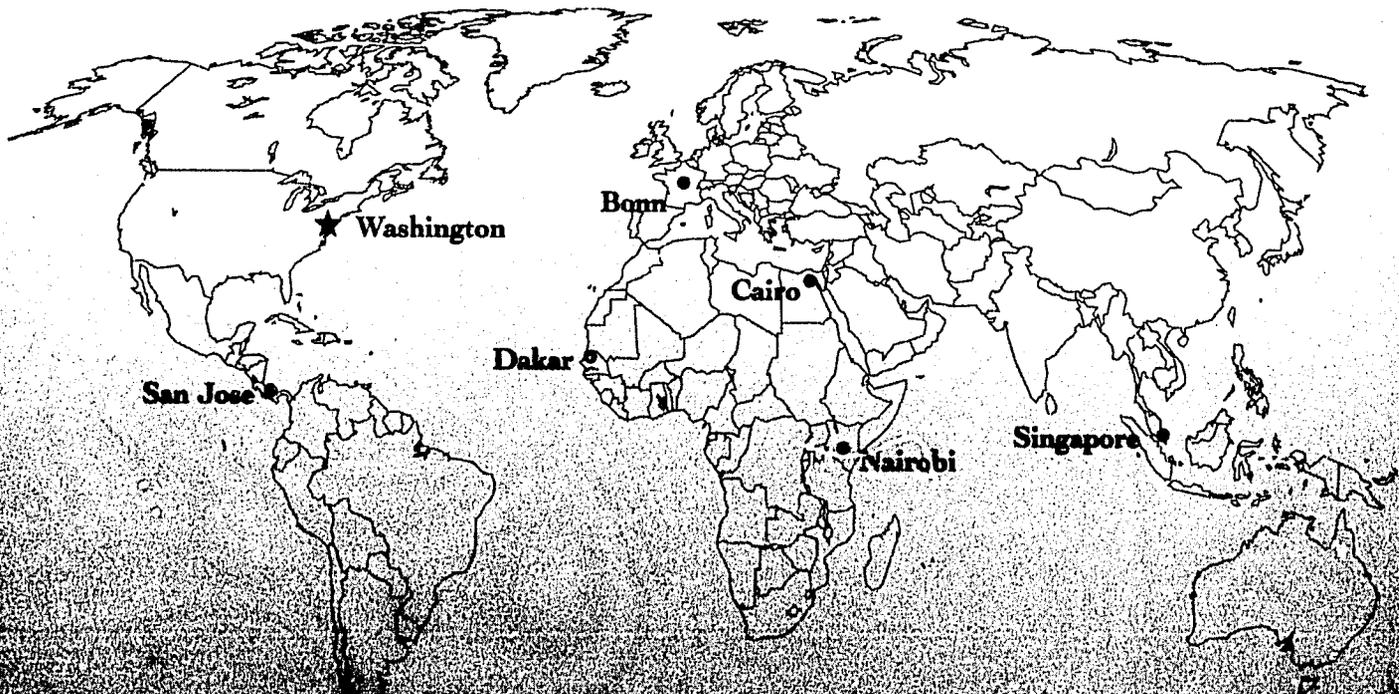

**PROJECT BENEFIT SUSTAINABILITY
AT USAID/SRI LANKA**

**Audit Report No. 5-383-95-07
March 31, 1995**





U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

March 31, 1995

MEMORANDUM

TO: David A. Cohen, Mission Director, USAID/Sri Lanka

FROM: Richard C. Thabet, RIG/A/Singapore

SUBJECT: Audit Report of Project Benefit Sustainability at USAID/Sri Lanka
(Audit Report No. 5-383-95-07)

Enclosed are five copies of the subject report. Our audit work showed that the benefits of USAID/Sri Lanka-financed projects continued after USAID funding stopped.

This report contains two recommendations designed to improve project benefit sustainability at your Mission. The first recommendation is to define the project benefits expected and to develop an "exit strategy" during project design. The second recommendation is to strengthen project benefit sustainability during project implementation by evaluating sustainability in interim evaluations and assessing sustainability of project benefits in final evaluations and close-out reports. Your response to the draft was fully considered in finalizing the report. Your comments are summarized after each finding and included in their entirety as Appendix II. Based on your comments, all recommendations are resolved and Recommendation 2.1 is closed.

Please provide us information within 30 days indicating any actions planned or taken to close the open recommendations. I appreciate the cooperation and courtesies extended to my staff during the audit.

Attachments: a/s

EXECUTIVE SUMMARY

Sustainability of project benefits is not a new concept. It was addressed in USAID literature as early as 1979. In March 1988, USAID reviewed 212 evaluation reports and projects and found that the benefits of only 11 percent of these projects had a high prospect of being sustained after termination of U.S. assistance.

Although project benefit sustainability has been a concern in the Agency for many years, there is no clear official definition of it. Nor do USAID Handbooks directly address the concept of sustaining project benefits. A 1990 publication of USAID's Center for Development Information and Evaluation defined project benefit sustainability as the ability of a system to produce outputs that are sufficiently well valued by beneficiaries (users of the goods and services produced) and stakeholders (others who have an interest in what the system does) so that enough inputs are provided to allow performance to continue thereby leading to long-term benefits and impacts (page 1).

We audited the sustainability of benefits from USAID/Sri Lanka-financed projects to determine if the benefits continued after USAID funding ceased, if the projects were designed to produce sustainable benefits, and if evaluations and close-out reports addressed sustainability (page 3 and Appendix I). We found the following:

1. The benefits of three completed projects sampled continued after USAID funding stopped. The Water Supply and Sanitation project resulted in a better managed and more effective national water department. The Mahaweli Basin Development project settled a large area resulting in increased food production and agricultural employment. However, the full benefits anticipated by the project have yet to be realized. Only the Private Enterprise Promotion project did not achieve the benefits originally envisioned, and its future financial viability is questionable (page 4).
2. The project design for the three completed and two new projects sampled discussed some methods to sustain project benefits. The Project Agreements also provided some methods to sustain project benefits, e.g. that Sri Lanka financed part of the project costs.

However, the benefits to be sustained were not well defined during the project development phase. Consequently, the project design did not incorporate sufficient activities necessary to help sustain benefits. The project design needs to include an exit strategy to plan for continuation of benefits after USAID's funding stops (page 17).

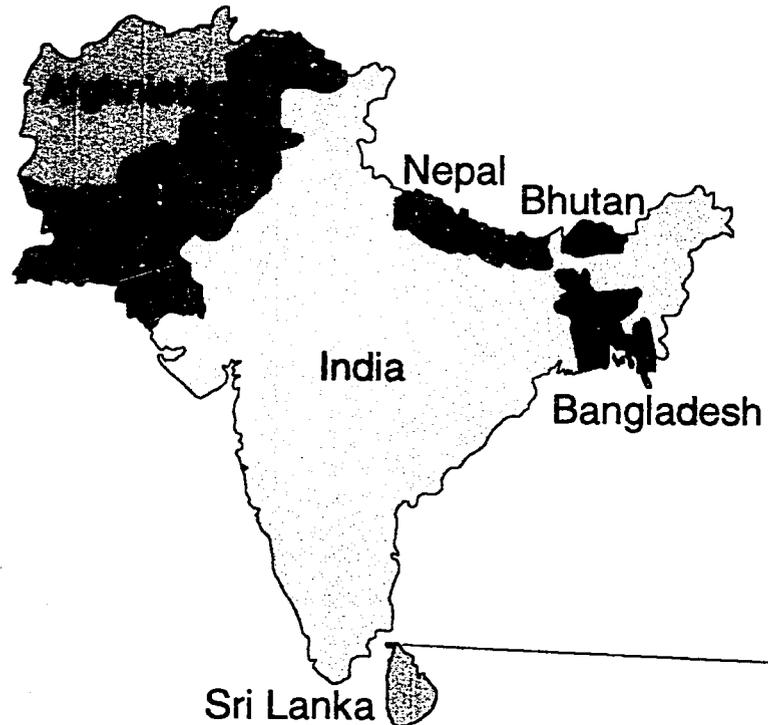
3. Evaluations should be designed to answer whether the effects of the project are likely to be sustained after USAID's funding stops. However, only one of the three projects sampled addressed the question of sustainability in the evaluation reports. None of the three projects sampled directly addressed sustaining project benefits in Project Assistance Completion Reports (page 24).

Overall, the benefits of USAID/Sri Lanka-financed projects have continued after USAID's funding had stopped. This report contains two recommendations directed toward increasing the effectiveness of the Mission's project design and implementation processes for sustaining project benefits (pages 18 and 25).

A draft of this report was provided to USAID/Sri Lanka officials for comment. In responding to the draft report, USAID/Sri Lanka generally concurred with the audit findings and recommendations. The Mission also provided suggestions for improving the presentation of the findings which we considered in finalizing the report (Appendix II).

Office of the Inspector General

Office of the Inspector General
March 31, 1995



Sri Lanka

Area: 24,959 square miles

Population: 17.5 million

Capital: Colombo

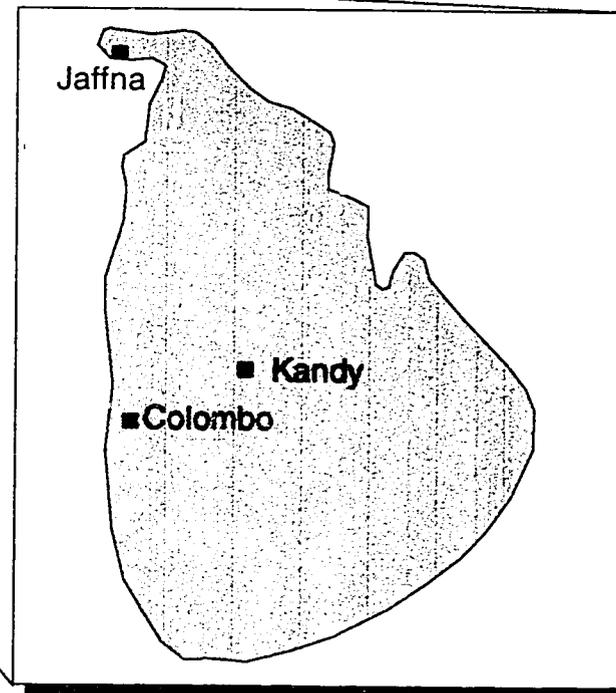


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INTRODUCTION

Background

Section 101 of the of the Foreign Assistance Act as amended stipulates that one of the four principal goals of United States Foreign Assistance is:

"the promotion of conditions enabling developing countries to achieve self-sustaining economic growth with equitable distribution of benefits;"

This goal deals with the higher level process of sustainable development addressed in USAID's March 1994 "Strategies for Sustainable Development." Although sustainable development and project benefit sustainability are linked, they are two separate concepts that operate at different levels in the development assistance spectrum. Sustainable development is a theory used by USAID to formulate a development strategy and to develop a program for a country. Project benefit sustainability relates to continuing a stream of benefits produced from a specific project.

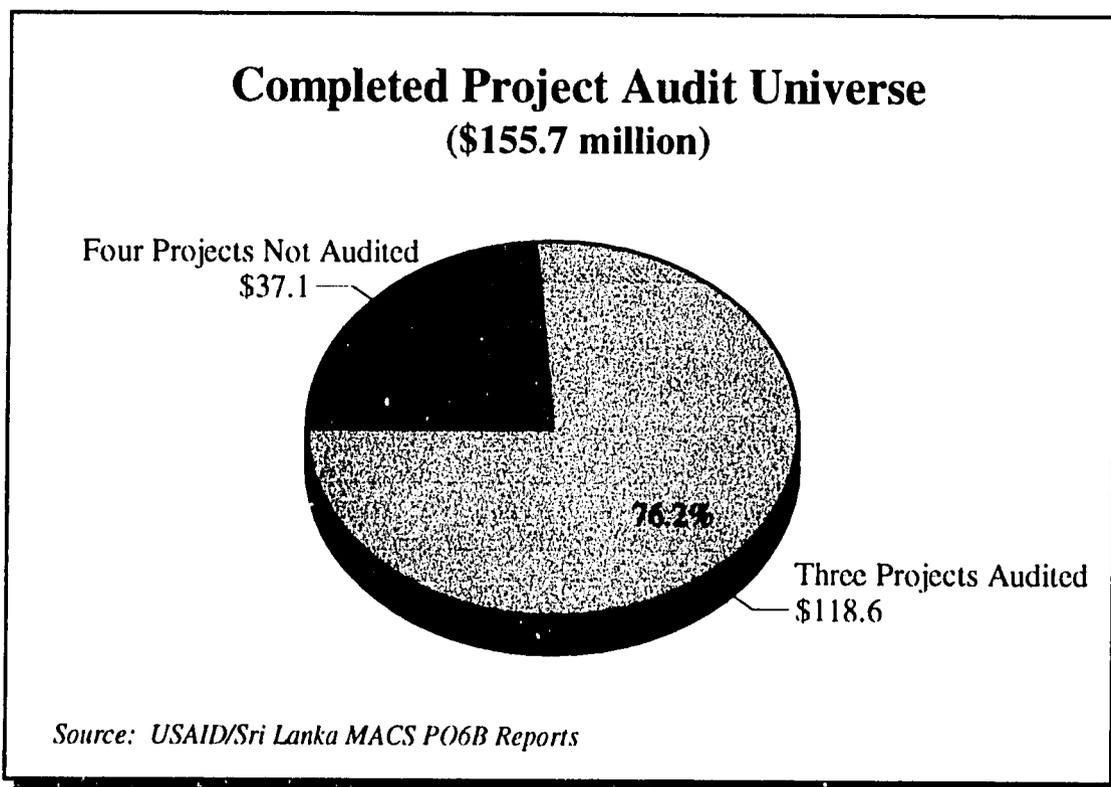
Sustainability of project benefits is not a new concept. It was addressed in USAID literature as early as 1979. In May 1982, USAID issued a policy paper on recurrent costs that addressed financial sustainability of project benefits, a component of benefit sustainability. Although sustaining project benefits has been a concern of the Agency for many years, there is no official clear definition of project benefit sustainability.

There are many definitions of project benefit sustainability. A 1990 publication of USAID's Center for Development Information and Evaluation defined project benefit sustainability as the ability of a system to produce outputs that are sufficiently well valued by beneficiaries and stakeholders that enough inputs are provided to allow performance to continue, leading to long-term benefits and impacts. USAID Handbook 3, Chapter 12 provides this definition:

"Sustainability - Are the effects of the project likely to become sustainable development impacts--that is, will they continue after AID funding has stopped?"

In March 1988, USAID reviewed 212 evaluation reports and projects and found that the benefits of only 11 percent of the 212 projects had a high prospect of being sustained after termination of U.S. assistance. A later review of 268 evaluations and reports that were completed in Fiscal Years 1989 and 1990 concluded that the benefits of only 44 of the projects reviewed (9 percent) had a high probability of being sustained after USAID's funding ceased. Of these 44 projects, the benefits of only 18 percent were identified as highly sustainable.

USAID/Sri Lanka financed seven projects that were completed between January 1, 1990 and December 31, 1992. The Mission spent \$155.7 million for these projects. We sampled three of the seven USAID/Sri Lanka-financed projects as shown in the chart below.



In addition, we reviewed two new projects with obligations of \$9.3 million that were initiated between January 1, 1992 and December 31, 1993.

Audit Objectives

The Office of the Regional Inspector General for Audit, Singapore audited USAID/Sri Lanka-financed completed projects to answer the following audit objectives:

- **Did the benefits of USAID/Sri Lanka-financed projects continue after USAID's funding ceased, and if so, what were the factors which contributed to sustaining those benefits?**
- **Did USAID/Sri Lanka design sustainability into projects?**
- **Did USAID/Sri Lanka address sustainability in project evaluations and close-out reports?**

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

REPORT OF AUDIT FINDINGS

Did the Benefits of USAID/Sri Lanka-financed Projects Continue After USAID Funding Ceased, and if so, What Were the Factors Which Contributed to Sustaining Those Benefits?

The benefits of USAID/Sri Lanka-financed projects continued after USAID funding ceased. However, the benefits of only one of the three projects sampled were clearly sustainable. The benefits of the other two projects also continued but the future financial viability of the activities is questionable.

There are many definitions of project benefit sustainability. However, the common element in most definitions of sustainability refers to a continuing stream of benefits after external assistance ceases. Handbook 3, Supplement to Chapter 12, defines sustainability as the following:

"Sustainability - Are the effects of the project likely to become sustainable development impacts--that is, will they continue after AID funding has stopped?"

An evaluation, "Sustainability Assessment of the Mahaweli Agriculture and Rural Development Project" identified the following six indicators of project benefit sustainability.¹

Economic: Do the activities generate real returns that equal or exceed the cost of capital?

Financial: Do the activities bring in more money than it costs to operate, i.e., is there a source of funds to cover the operations and maintenance of the activity?

¹ The wording of these indicators has been slightly modified based on comments given by the Office of Policy and Program Coordination after its review of the draft audit report.

Technical: Are the techniques used appropriate and affordable?

Environmental: Do the activities conserve or enhance the natural environment?

Cultural: Do project activities fit with the historical, cultural, and conceptual realities of the people and groups with whom the project works?

Institutional: Are the institutions supported or created by the project administratively and managerially efficient, appropriate, and effective?

Using the above indicators, we answered the questions associated with each of the indicators for the three completed projects sampled. These six indicators are also closely linked to the typical analyses made during USAID's project design process. The results of our assessment are shown in the following table.²

Sustainable Indicators	Water Supply and Sanitation Project	Mahaweli Basin Development Phase II	Private Enterprise Promotion
Economic	Yes	No	No
Financial	Yes	No	No
Technical	Yes	Yes	No
Environmental	Yes	No	N/A
Cultural	N/A	Yes	Yes
Institutional	Yes	No	No

² This table is for illustrative purposes. It is not intended to infer that unless all indicators were achieved, the project benefits were not sustainable. Each indicator carries a different weight, depending on the type of development activities.

The Water Supply and Sanitation Project resulted in clearly sustained benefits. The other two projects—the Mahaweli Basin Development Project Phase II and the Private Enterprise Promotion Project—produced some sustained benefits, but they did not achieve some of the sustainable indicators.

A brief description of the three projects and the benefits resulting from the projects are outlined below.

Water Supply and Sanitation Project

The purposes of this project were to develop and improve:

- the institutional capabilities of the National Water Supply and Drainage Board to plan, design, rehabilitate/construct, operate and maintain water and sanitation systems throughout Sri Lanka; and
- the national health, education, rural sanitation services, and community participation in water supply and sanitation.

This project was completed on August 31, 1991. USAID provided \$11.4 million for technical assistance, commodities, construction, and training. The Government of Sri Lanka contributed \$5.4 million primarily for vehicles, machinery, and training.

The project resulted in a better managed and more effective national water department. One factor contributing to the project's success was the decentralization of the organizational structure. It allowed the Regional Support Centers to be more responsive to customer needs. According to the Final Report on Institutional Development of the National Water Supply and Drainage Board prepared by consultants in August 1991, the number of water connections per employee doubled from 1984 to 1990, while the production of piped water increased from 155 million cubic meters to 219 million cubic meters. There was also an increased emphasis in training for regional staff. The ratio of training for regional staff to head office staff increased from 1 in 26 in 1984 to 5 to 1 in 1990.



The Central Region Support Center in Kandy was built with USAID's funds under the Water Supply and Sanitation Project. Photo taken in May 1994.



Beneficiaries using a water stand-post built with USAID's funds under the Water Supply and Sanitation Project. Photo taken in May 1994.

The successful technical assistance component of this project was an important factor in producing sustainable benefits. This assistance helped the organizations to shift from an emphasis on engineering services to a greater emphasis on operations, maintenance, and customer services. A Board official commented that the technical assistance team was very effective over the life of the project, and provided effective management training. Follow-up technical assistance provided after the project had ended also contributed to continuing the project's benefits.

The Regional Service Centers were also given greater financial responsibilities, collections increased, and customer services improved. In 1984, collections per employee were Rupee 9,180. According to the consultant's Final Report, collections in 1990 had increased to Rupee 59,203 per employee, or an increase of over 600 percent. Similarly, billings for water more than doubled during this period from Rupee 224 million in 1984 to Rupee 503 million in 1990. According to the Board, only 23 percent of the operational costs were met by the billings prior to the start of this project. For the year ending 1993, the revenues covered 100 percent of its operating and debt service costs.

Some components of this project, e.g., the institutionalization of the Rural Sanitation and the Corporate Planning Unit, did not fully achieve the desired result. Overall, however, this project was very successful. A Sri Lankan official commented that the National Water Board is the best-managed government corporation in Sri Lanka because the professional staff anticipated needs through planning and met performance expectations.

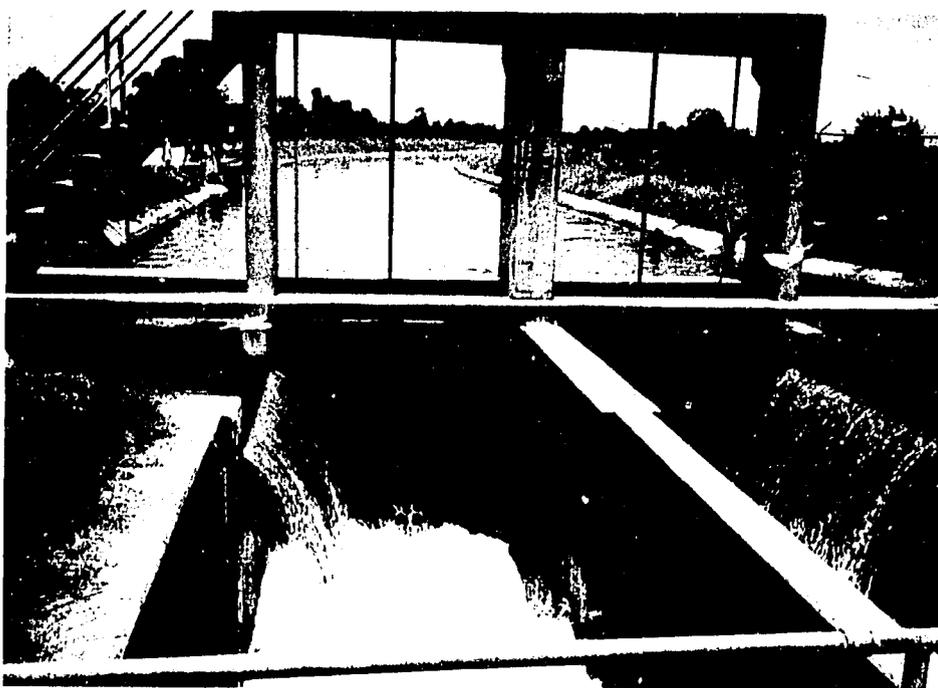
Section 102 of the Foreign Assistance Act of 1961, as amended, which outlines Development Assistance Policy stipulates that United States assistance should focus on establishing and upgrading the institutional capacities of developing countries to promote long-term development. This project embodies the policy. Overall, the project benefits were sustained because of the shift of management emphasis to operations and customer service, the successful training component, and the improved financial indicators.

Mahaweli Basin Development Phase II

The purpose of this project was to develop an area of the Mahaweli River Basin (System B) by constructing roads, schools, medical facilities, and an irrigation system and by settling families into the region to farm the land. The development of System B was part of a large multi-donor program

initiated in 1978 to develop the entire Mahaweli Basin Region. In addition to System B, five other areas are being developed. System B represents about 15 percent of the Mahaweli's cultivated land.

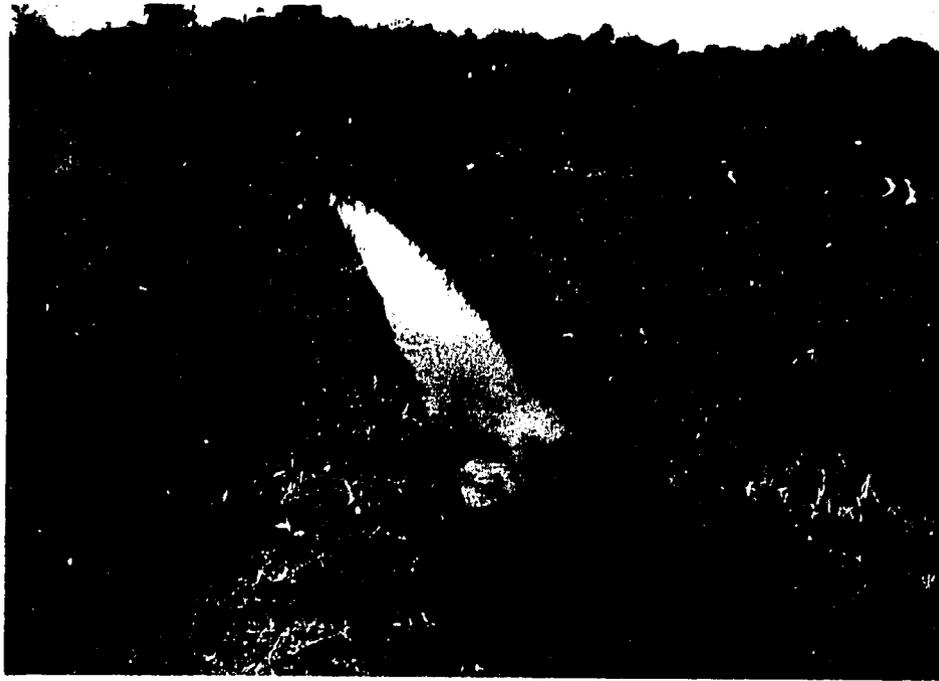
USAID financed \$100.3 million to construct 125 kilometers of irrigation canals. In addition, USAID funded \$2.9 million for technical assistance to help the Mahaweli Authority of Sri Lanka identify, establish, and train personnel to operate and maintain the irrigation system. The canal was completed in August 1986, but the project completion date was in June 1991. According to Mission records, the Government of Sri Lanka contributed \$133.2 million to finance the construction of roads, canals, schools, and medical facilities. Sri Lanka also assisted the settlers to clear the land and develop the farms.



Portion of the 125 kilometer concrete-lined irrigation canal financed by USAID under the Mahaweli Basin Development project. Photo taken in April 1994.

At the end of 1993, most of the project objectives had been achieved. The project resulted in 125 kilometers of irrigation canals that are well

maintained and provide an adequate water supply for irrigation. About 19,000 families were settled into System B, and they grew about 108,000 tons of rice in 1993. In addition, about 3,700 tons of other crops such as chillie, maize and vegetables were produced. Most of the project's targeted outputs were achieved.



Distribution canal providing water to irrigate land for the System B farmers.
Photo taken in April 1994.

To achieve the project objectives, seven other USAID projects contributed to the development of System B. Two projects were directly linked to the Mahaweli Basin Development Phase I project to finance the design of the irrigation system while the Phase III project helped Sri Lanka to pay an arbitration settlement arising from a dispute between the construction contractor and Sri Lanka. Two other projects, Mahaweli Downstream Support and Mahaweli Agriculture and Rural Development, were designed to increase settler income and to construct other canals. Three other projects (Mahaweli Sector Support, Mahaweli Environment, and Mahaweli Enterprise Development) were partially directed toward developing the System B area. The total invested in developing System B through

December 1993 was about \$348.9 million for the eight projects. USAID financed about \$161 million (46 percent) and Sri Lanka contributed \$187.9 million.

However, the full economic benefits anticipated by the project have not been realized as of May 1994. Project design documentation and the Project Agreement covenants included two elements—land tenure and irrigation system financing costs—which could help sustain the project's benefits financially. However, neither of these covenants were implemented. The System B settlers are issued permits to use the land subject to certain conditions. However, they do not own the land or have the right to sell the property. A system to charge user fees to pay for maintenance of the canals was also not implemented by the end of the project. In May 1994, Sri Lankan officials said they had a plan to turn over the maintenance of the distribution canals to farmer organizations.

In sum, this project produced most of the outputs originally envisioned during the design of the project. The project resulted in the settlement of about 20,000 families which helped reduce unemployment and contributed to food production for Sri Lanka. However, not all the benefits anticipated have been achieved.

Private Enterprise Promotion Project

The purpose of this project was to improve the investment climate in Sri Lanka. There were four principal components in this project: the establishment of a Sri Lanka Business Development Center; management training and entrepreneur development; feasibility studies to identify investment opportunities; and analyses of policies, procedures, and programs affecting the private sector.

The project was the first major effort financed by USAID/Sri Lanka that was directly aimed at promoting private sector activity. This project started in 1983 and ended in August 1990. USAID spent \$3.9 million primarily for technical assistance, and Sri Lanka contributed \$3.6 million. According to an assessment of USAID/Sri Lanka-financed private sector projects, this project fell short of expectations, but it was not a bad first effort.

The Sri Lanka Business Development Center was established under this project as a non-profit organization to:

- corroborate and articulate the viewpoint of the business community on major investment climate issues, thereby

establishing and maintaining a healthy environment for business development;

- provide a comprehensive range of services to promote private sector investment in Sri Lanka and foster its growth;
- identify, motivate, and support entrepreneurs throughout the country with emphasis on micro and small scale enterprises; and
- upgrade management expertise to fulfill the development needs of the business community.

Although the Center is still in operation, the impact envisioned during the project design was not achieved. The Center never acted effectively as a mediator between the government and the private sector to spearhead discussions in economic and business policies. The Center had a marginal impact on business activity and private sector development because its activities were not coordinated or focused. Problems arose from the start because of a strained working relationship between the USAID contractor, the Center's management, and the Ministry of Finance and Planning.

The Center was established as a non-profit organization but is having difficulty meeting its operating costs. Although the Center was designed to train the poor in rural areas, these poor clients cannot afford to pay the fees which are necessary to cover the Center's operating costs. According to a former executive director, the Center was designed to provide subsidized services, but the project did not include a financing mechanism for its activities after USAID's funding stopped. The USAID Policy Paper on "Recurrent Costs" suggests that if recurrent costs constitute a serious problem then, missions should consider funding a portion of the recurrent costs if the host government policies are appropriate and the projects were correctly designed. Currently, the Center's primary source of revenue is from other donors, such as Germany and Canada. According to Center officials, the Center would not be able to continue its training program without these donations.

* * * * *

Overall, the benefits of the three completed projects continued after USAID's funding stopped. The results produced by the Water Supply and Sanitation project are continuing to benefit Sri Lankans because of

technology transfer and the financial viability of the water department. In addition, the Mahaweli Basin Development project settled a large area, resulting in increased food production and agricultural employment. However, all the benefits anticipated have not been achieved. Only the Private Enterprise Promotion project did not achieve the benefits originally envisioned, and its ability to continue operations is questionable.

Management Comments and Our Evaluation

USAID/Sri Lanka officials generally agreed with analytical framework to analyze project sustainability; however, they believed the table was an oversimplification because it inferred an equal weight for each indicator. We agree that the application of different weights to the indicators based on project characteristics would provide a better indication of project benefit sustainability, but we did not have the information necessary to apply such weights to each project. The purpose of the table was to give a general indication of project sustainability. The continuing project benefits are discussed in greater detail in the subsections following the table.

USAID/Sri Lanka said that the Mahaweli Basin Development II Project's:

"...ultimate sustainability has always been tied to subsequent agricultural and production investments, by the GSL and donors (including USAID), some of which are still ongoing."

It may have been USAID/Sri Lanka's intent to tie the project's ultimate sustainability to subsequent agricultural and production investments, but the project design documentation did not indicate this nor identify the additional costs associated with these subsequent efforts. We believe that if additional investments are needed to sustain project benefits, then the design documents should include this information. This additional information would help management to make a more informed decision on whether to fund the project and the follow-up projects, or to apply those resources to another project that may be more productive.

We agree with the Mission's comment that the Mahaweli project continues to produce continuing benefits in the form of adequate water supplies, and canal maintenance. This audit did not review the improved performance of GSL institutions' ability to manage System B, so we cannot comment on this benefit. The Government of Sri Lanka did have a plan to turn over the maintenance of the distribution canals to the farmer organizations. However, the Government of Sri Lanka plan did not include the turn over for maintenance of the main and branch canals to the farmer organizations.

The Mission did not agree with our conclusion that the Private Enterprise Promotion Project's impact and future viability are questionable. According to an October 1993 assessment of the impact and options of the USAID/Sri Lanka Private Sector Development Program, the project did not achieve the desired results. It says:

"In sum, three of the four divisions of SLBDC performed their tasks adequately, but with only marginal impact on actual business activity or private sector development in general; and their activities were not satisfactorily coordinated or focused. Only the policy division failed completely."

We agree with the Mission's comment that the Sri Lanka Business Development Center has continued to train Sri Lankans without USAID's funding. However, according to the Center's Managing Director and Corporate Manager, the Center was not able to generate sufficient funds to cover operating expenses. In addition, a former employee of the Center and member of the USAID consultant team who performed the survey for Private Enterprise Promotion Project, expressed similar concerns for the Center's financial viability.

Did USAID/Sri Lanka Design Sustainability into Projects?

USAID/Sri Lanka included elements in the design of projects to help sustain project benefits. Although indicators of project benefit sustainability were incorporated into some elements of the project design, the Mission did not clearly define the benefits to be sustained or develop a strategy to help ensure that project benefits were sustained.

We reviewed three completed and two recently initiated projects to identify elements in the project development process that would help sustain project benefits. A discussion of these elements follows.

Conditions and Covenants

Conditions and covenants included in project design documents and agreements specify actions which the host country must take to implement the project, or actions which are necessary to optimize the project benefits. Conditions and covenants listed in the project design documents and agreements should guide the host country towards ensuring that project benefits are sustained after USAID's funding stops.

The design documents for all five projects sampled included some covenants and conditions that could help sustain project benefits. Such covenants and conditions included land policies, impact evaluations, reorientation of Sri Lanka laws and policies, and financing recurrent costs.

Technical Analysis

USAID Handbook 3 stipulates that the Technical Analysis should answer the feasibility of implementing the project. In addition, the analysis should determine whether the methods proposed are the most suitable for the local environment. Therefore, a plan for technology transfers during the life of the project should exist to ensure continuity. This plan would include the hiring of experts or consultants and, if these experts were foreigners, their technical skills should be transferred to the host country's nationals. The length of the contract with the consultants should be realistic to ensure that host country nationals fully understand the new technologies.

All five projects sampled had a Technical Analysis which included discussions of technology to be used during project implementation. For example, both the Mahaweli Basin Development Phase II and Water Supply and Sanitation projects included plans to up-grade skills and to provide technical experts to help sustain project benefits. While the Water Supply

and Sanitation project focused on institutional building, the Mahaweli Basin Development Phase II analysis was more concerned with infrastructure development. The Private Enterprise Promotion and Promotion of Private Infrastructure projects included plans to use the expertise of Sri Lanka's institutions to provide entrepreneur and business development training. The technical analysis for the Agro-Enterprise project identified prior government policies that constrained development in the private sector agriculture enterprises.

Social Analysis

Social soundness of a project contributes to sustainability because it defines the project's direct and indirect beneficiaries, and addresses the expected impact of benefits. USAID Handbook 3 defines three objectives of the social soundness analysis. They are to: (1) help shape project design elements as they advance through various decision stages during project development, (2) strengthen other analyses (e.g. technical analysis), and (3) confirm the social/cultural feasibility of the overall activity.

Design documentation for all five projects reviewed contained discussions on the social impact of the projects. Some design documents also presented social issues that have particular bearing on the continuing success of the project. For example, design documents for the Mahaweli Basin Development Phase II discussed the need to include infrastructure such as roads, schools, and markets to develop the area. In addition, the need for land tenure policy for the settlers was also raised in the design documents. The Project Agreement included a special covenant to provide settlers with full control over their land and eventual ownership. However, as of April 1994, the settlers still did not own the land they settled and farmed.

Administrative Analysis

The Administrative Analysis identifies where to assign the project implementation functions of the host country agencies and USAID. Appropriate assignment of these functions contributes to the sustainability of project benefits because the commitment of the host government is secured.

Design documents for four of the projects included establishing indigenous centers to implement the projects and, in most cases, assigning responsibility to the host government as a monitoring party. The Administrative Analysis for the Agro-Enterprise project did not identify a specific implementing agency. Rather, the project design planned to use

the private sector to implement the project, and to establish an Agro-Enterprise Project Advisory Board to advise on project implementation.

Project Agreements

The Project Agreement is a written understanding between the parties on the responsibilities for and timing of actions with respect to a given project. Since this Agreement is a legally binding document, it is important to analyze the clauses to see if planned actions that would enhance the sustainability of project benefits were included in the document.

The contents of the five Project Agreements we sampled reflected the contents of their respective design documents. Many of the covenants and special conditions in the agreements helped to ensure sustainability by requiring the host government to implement conditions which could sustain project benefits. Some of these conditions included policy reforms, and the establishment of indigenous institutions to implement and monitor the projects. In addition, host country contributions for all five projects were above the required minimum 25 percent, and participation of the host government in the projects was well designed.

* * * * *

Although USAID's project development process does not have procedures directly related to sustaining project benefits, indicators that project benefit sustainability was an underlying concern and were contained in the design documents and Project Agreements. However, USAID/Sri Lanka could enhance its project development process by defining the benefits to be sustained and developing an exit strategy in the design documents. These two areas are discussed in detail below.

The Project Design Needs to Clearly Define the Benefits to Be Sustained and to Identify How These Benefits Should Be Sustained

USAID's new emphasis is to focus on project results. However, USAID/Sri Lanka's project development documents did not define the benefits to be sustained for projects, or describe how these project benefits could be sustained after USAID's assistance ceased. This occurred because USAID's design process does not include specific procedures to define benefits to be sustained or to develop a strategy for sustaining project benefits.

USAID/Sri Lanka could increase the effectiveness of projects by designing sustainability into projects.

Recommendation No. 1: We recommend that USAID/Sri Lanka:

- 1.1 identify the benefits expected to be sustained in project design for each project; and**
- 1.2 develop in the project design an exit strategy directed toward sustaining these benefits.**

The Agency issued a new guidance directive for project development on October 12, 1994 which places greater emphasis on planning and managing for development results. This document identifies three main objectives in the new project planning process. One of the objectives is to provide a framework for monitoring the project's contribution to the strategic objective(s), related program outcome(s), and the specific results the project is expected to produce.

Project design documentation defines the purpose and higher level goal of the project. This design documentation summarizes various analyses completed during project development. In addition, the design documents are used to identify measurable outputs (which are not necessarily the benefits to be sustained) and focus on end-of-project completion (not on continuing the project benefits). However, USAID Handbook 3 procedures have not required the project design to define the benefits to be sustained, or to develop a strategy to help ensure that these benefits continue after USAID's funding stops. The following two sections discuss these issues.

Benefits to Be Sustained Should Be Defined in the Project Paper

The Project Paper has been the basic reference for projects, and it represents the final design which includes the project's goal, purpose, and output(s). All five project papers identified the purposes and outputs of the project. However, none of the five Project Papers reviewed identified the benefits to be sustained after USAID financing ends. For project benefits to be sustained, the benefits identified and post project financing must be considered during the design phase of the project.

Project objectives are the project outputs, purposes and goals as spelled out in the project design documentation. USAID Handbook 3 explains that:

"The precise definition of project objectives is the highest order of design tasks. Even though objectives (outputs, purpose(s), goal) may change, and, as a result of project development, their specification and subsequent pursuit is the central focus about which all other aspects will be molded."

Thus, it is important that the objectives spelled out in the project design be specific, realistic, and measurable. This allows implementation to focus on project results.

All five project designs sampled (three completed and two new projects) contained vague or unrealistic goals, i.e., not achievable considering the planned project period. For example, the recently initiated Promotion of Private Infrastructure project was designed to be completed in four years. This project is to assist the Government of Sri Lanka to develop a market for the private financing and management of the country's economic infrastructure. Its goal is "to modernize economic infrastructure in six primary sectors: power, water supply and treatment, telecommunications, transportation, waste management and disposal, and industrial estates/facilities." This was an ambitious goal for a \$10.7 million project that was scheduled to last for only four years. Project objectives should be realistically worded in measurable terms and geared towards achieving sustainable benefits within the specified time-frame.

To assess if project benefits are sustainable, all parties need to agree on the definition of sustainability. Sustainability has different meanings to people with different functions in the development business. Consequently, it is important to define the benefits to be sustained early in a project so that objective assessments during a project's implementation can be made from a defined perspective.

Just as varied functions bring about varied definitions of sustainability, projects with different themes (e.g., agricultural, social, private enterprise or health) have different benefits to be sustained. USAID's Food and Agricultural Development Policy identifies the need for increased productivity and employment. The benefits to be sustained from constructing irrigation canals are not the completed canals, but the food produced and the employment resulting from increased crop production. The continued benefits of a private enterprise project may be a functioning institution that coordinates with the government to accelerate policy reforms which will stimulate the economy. Due to these different benefit

flows, it would not be feasible to assess sustainability of different projects based on a single set of criteria. Criteria need to be separately identified and defined for different projects. As such, each project design should define the benefits to be sustained. These benefits should be described in detail and quantified where applicable so that they may be easily tracked and evaluated.

Project Plans Should Identify How Benefits Will Be Sustained After USAID's Assistance Has Ceased

USAID/Sri Lanka's project development documents generally did not describe how project benefits would be sustained after USAID's assistance ceased. Only one of the newer project designs considered post project financing.

During the design phase of projects, it is important to consider the elements necessary to ensure the continuation of project benefits after USAID's funding stops, i.e., a project exit strategy. The April 1993 empirical study sponsored by the Asia Bureau identified project design as a critical influence on sustaining project benefits. In addition, a recent draft document prepared by the USAID's Center for Development Information and Evaluation identified the need to incorporate sustainability in the design of projects. USAID's procedures have required project designs to have an implementation plan, monitoring and evaluation plans, and cost estimate and financial plan. However, these plans do not address how the project benefits will continue after the assistance stops. For project benefits to be sustained, an exit strategy should be developed during the design of the project.

A key component of an exit strategy is a financial plan which will help to ensure that benefits generated during project implementation will continue after USAID's funding stops. USAID Handbook 3 defines the purpose of a financial analysis as twofold:

- (1) to determine that the proposed activity will be financially viable and have monetary value to the direct participants (i.e. that revenues will be of such amounts and received in such time periods as to be larger and more valuable than the stream of projected expenses); and
- (2) to determine that the stream of projected expenses can actually be financed (paid for) by project participants as envisioned in the implementation plan.

The second purpose is in line with the USAID's May 1982 policy paper on "Recurrent Costs." This paper defines recurrent or variable costs as those costs that recur, as opposed to capital or fixed costs which are concentrated at the beginning of a project's life. The paper goes on to say that missions and host governments should work to design projects so as to help ensure that recurrent cost components are consistent with economic feasibility.

Post project financing is an important consideration when developing projects that will result in sustained benefits. The countries where USAID operates are typically the least developed and financially needy. Thus, the ability of countries to generate revenues necessary to pay recurrent costs is an important factor that should be considered during the project design. If funds are not available to finance post project activities, the benefits produced by the project may not continue. Therefore, a greater emphasis should be placed on developing an exit strategy during the project design to ensure that the benefits generated during the project continue after USAID's funding stops. Some financial factors to consider in an exit strategy are: a) Does USAID plan to continue funding the project, or should USAID involve other donors in the project? b) Should an endowment fund be set up to earn interest which may be used to help fund recurrent costs? c) Should the project designers plan to set up a profit-making body to ensure that a steady stream of private financing is available to continue project activities? These are examples of financial options that need to be decided, so that appropriate actions may be planned to help ensure that project benefits are sustained.

Only one of the five projects sampled considered post project financing. The Promotion of Private Infrastructure project included an exit strategy to create a "Private Sector Infrastructure Development Fund" to attract long-term financial support from other donor agencies. This fund will allow the private sector access to official development assistance, serve as a catalyst to promote private infrastructure projects, and alleviate the shortage of long-term financing. The effort to look beyond the "end-of-project" should help sustain the infrastructure development activities designed into this project. This effort will also help to ensure the project's financial viability after USAID funding ceases. Just as the sustained benefits should be identified during project design, each project design should describe how the benefits are to be sustained.

* * * * *

To design sustainable projects, the benefits to be sustained should be identified and defined during the project development phase. Otherwise, the implementation, monitoring and evaluation, and financial plans developed during project design may not incorporate activities necessary to sustain these benefits. Project development and implementation occurs over a long period, often up to 10 years. The project design also needs to include an exit strategy to plan how the benefits will be continued after USAID's funding stops. The exit strategy will also help Project Officers to better manage the project during its implementation so that its benefits will be sustained. USAID/Sri Lanka needs to identify the benefits to be sustained and incorporate an exit strategy in its project design. These two actions will help Mission-financed projects to continue providing benefits after USAID assistance ends.

Management Comments and Our Evaluation

USAID/Sri Lanka generally agreed with the recommendations. The Mission is incorporating more sustainability measures in their project designs, and it has established new Mission-based standards to address sustainability in its projects. However, the Mission believes that these recommendations should be redirected to USAID/Washington because it is an Agency-wide issue which requires some measure of standardization among the missions. We agree that USAID/Washington should provide standardization, but at this point in our Agency-wide audit, we have not identified this issue as a systemic problem that requires action by USAID/Washington.

The Mission also stated that USAID's requirement to specify "End of Project Status" accomplishments has always, by implication, been considered to have the purpose of continuing benefits. However, not all projects are designed to produce continuing benefits. The Mission further comments that "the lack of specificity in the definition of terms of describing sustainable benefits handicaps the Mission's ability to ensure that these benefits are sustained after the project is over." We agree that a better definition of project sustainability is needed and each project needs to clearly specify the benefits to be sustained.

We agree with the Mission's comment that an exit strategy can be better defined after the project has been implemented. But we believe that it is important to include the exit strategy during the project's design, and this strategy should be up-dated as the project evolves to reflect the latest information. By including the strategy in the design phase, the designer(s) will focus more on continuing project benefits, and it will provide a better basis for management's decision to approve the project for implementation.

Based on the actions taken by the Mission, recommendations nos. 1.1 and 1.2 are resolved. The recommendations can be closed after RIG/A/Singapore receives and reviews the new Mission standards to address sustainability.

Did USAID/Sri Lanka Address Sustainability in Project Evaluations and Close-out Reports?

USAID/Sri Lanka did not address sustainability in two of the three project evaluations and close-out reports sampled.

The Water Supply and Sanitation project addressed project sustainability in the interim and final evaluation reports. The interim evaluation report included several recommendations to promote the sustainability of this project. The final evaluation for this project also addressed several factors which indicated that benefits will be sustained because of successful decentralized operations, community participation, up-graded management skills, and financial viability.

USAID/Sri Lanka also financed two evaluations that directly addressed project sustainability. Recently an evaluation of the "Sustainability Assessment of the Mahaweli Agriculture and Rural Development Project" was completed to promote the sustainability of agriculture in System B of the Mahaweli Region. The Mission also financed an impact assessment of its private sector program in October 1993 to analyze the successes and failures of the Mission's private sector development activities and to recommend actions for future activities.

Although USAID/Sri Lanka addressed sustainability in the evaluations of one project sampled, it could do more to improve project sustainability by requiring sustainability to be assessed in all its evaluations and close-out reports. This condition is discussed below.

Mission Can Improve Project Evaluations and Close-out Reports to Better Address Project Sustainability

USAID policy requires that evaluations and close-out reports be designed to answer questions concerning the sustainability of USAID-financed projects. However, USAID/Sri Lanka did not address project sustainability in two project evaluations or the three project close-out reports sampled. Consequently, the full impact of the benefits from project outputs originally envisioned by the Mission has generally not continued after USAID's assistance ceased.

Recommendation No. 2: We recommend that USAID/Sri Lanka:

- 2.1 assess project sustainability in the interim evaluations; and**
- 2.2 ensure that final evaluations and close-out reports determine if project benefits were achieved and the actions that can be taken to sustain these benefits.**

According to USAID Handbook 3, the Agency requires that evaluations are designed to answer questions concerning the sustainability, impact, relevance, efficiency, and effectiveness of USAID-assisted development activities. According to Handbook 3:

"These issues help focus evaluations on the major concerns of development managers. They force evaluators to go beyond mere examination of inputs and outputs and think about the more important questions of why the project is or is not having anticipated effects, ... what can be done to ensure that this investment produces enduring benefits. Attention to these issues makes the evaluation process useful in promoting policy dialogue."

We analyzed evaluation and close-out reports for the three sampled projects to determine if sustainability issues were substantively addressed during the project's interim period and at the end of the project. An interim evaluation was prepared for all three projects sampled, but only the Water Supply and Sanitation project addressed project benefit sustainability. A final evaluation was prepared only for the Water Supply and Sanitation project. This report concluded that the project had a strong likelihood of sustaining benefits. Project Assistance Completion Reports were prepared for both the Water Supply and Sanitation, and Mahaweli Basin Development projects. However, a report was not prepared for the Private Enterprise Promotion project. Neither of these Completion Reports directly addressed project sustainability.

Interim Evaluations

Interim evaluations were done for all three completed projects. However, only the interim evaluation for the Water Supply and Sanitation Project addressed sustainability concerns. The interim evaluations for the Private Enterprise Promotion Project and the Mahaweli Basin Development Project did not address sustainability. By not addressing sustainability early in these projects' implementation, possible strategies to sustain project

benefits were not evaluated, and consequently Mission personnel did not take full advantage of the evaluators expertise.

The interim evaluation report for the Water Supply and Sanitation project made several recommendations to promote sustainable benefits. First, the report recommended extending the technical assistance beyond the Project Assistance Completion Date to ensure that there was continued progress in the institutionalization of certain key institution building components. Second, the report recommended the development of a master plan to assess the future demand for water and water services. A strategic plan can then be developed to plan the resources necessary to meet such demand. Finally, the report recommended the establishment of water tariffs that will cover the economic cost of piped water. These recommendations were implemented during the latter part of the project and helped to sustain benefits. This is an example of how recommendations made during an interim evaluation can help USAID officials take actions to foster sustainable benefits.

An interim evaluation report was completed for the Mahaweli Basin Development Project in June 1985. The purpose of this evaluation was to assess the results of project activities and to determine the extent to which project outputs had been accomplished. The report identified several problem areas such as monitoring of the downstream infrastructure development and follow-up maintenance activities which appeared to be of low priority. It was the general consensus of the evaluators that maintenance of the irrigation system and buildings was not being done at a level to meet minimum standard requirements. While these operational problems were addressed in the report, maintenance of the canals was still being discussed in April 1994. Sustainability issues should be addressed in the early stages of project implementation. Thus, actions necessary to sustain benefits can be considered and acted on early in the project, thereby helping to increase the likelihood of continued project benefits.

The interim evaluation report for the Private Enterprise Promotion project did not address sustainability. This evaluation identified four major problems. They are: (1) progress fell short of expectations, (2) the host government agency programs did not have a significant impact, (3) technical assistance was substantially under-used because of a poor working relationship between the host government agency and the technical assistance contractor, and (4) USAID officials did not assign sufficient staff time to design and implement this complex project. The report recommended that the host government agency programs are re-oriented

from servicing the needs of large-scale enterprises to small and medium-scale enterprises. The host government agency should also seek financial support for its programs from donor agencies.

Final Evaluations

According to USAID Handbook 3, Chapter 12, evaluations are planned and undertaken for a variety of reasons. One reason cited for doing a final evaluation is to determine:

"...what additional actions are needed to sustain the positive effects of the effort;..."

Final evaluations can assist in identifying actions needed to continue those benefits already paid for. The final evaluation can also identify problems to help the missions to better design projects in the future to sustain benefits.

Sustainability of project benefits was addressed in the final evaluation for the Water Supply and Sanitation Project as required by Handbook 3. This evaluation concluded that the project had a strong likelihood of sustained performance because of factors related to the institution and the external environment. Some of the institutional factors which supported sustainability were the decentralized organizational structure, a strong financial consciousness and the financial viability of the organization, establishment of corporate planning, acceptance of the employee performance evaluation process, and the development of competent management skills. External factors which supported sustainability were favorable government policies, good relationships between the organization and local political groups, improved customer satisfaction, and the organization's effective management of water supply issues.

The Water Supply and Sanitation final evaluation also included a discussion of post project considerations to help ensure sustainability of the project. It discussed the need for an extension of technical assistance beyond the project completion date to finalize the work on decentralization of the Regional Support Centers, to maintain links with the External Support Agencies, and to assess in greater detail the potential for privatization of all or part of the Water Board's operations. Referred to as a "sustainable tail," it was built into the project to ensure that the project benefits were sustained. This final evaluation included successfully implemented recommendations which contributed to sustaining the project benefits.

The final Water Supply and Sanitation evaluation also identified two factors that could diminish sustainability of project benefits. First, a change in national government could result in the water tariff being abolished and the National Water Supply and Sanitation Board reverting to a subsidized welfare agency. Second, salary incentives may diminish as employees rise up the management ranks. This could adversely affect the development of managers because an individual's desire to take on added responsibilities tends to diminish without additional monetary incentives.

A final evaluation was not made for the Mahaweli Basin Development Project Phase II even though subsequent projects like the Mahaweli Agriculture and Rural Development, and the Mahaweli Downstream Support projects were initiated. The final evaluation was not prepared because the Project Officer believed that it would not add much to what was already known. The Project Activity Completion Report also served as a final evaluation.

A final evaluation was not made for the Private Enterprise Promotion project. Since this project's problems were well-known to Mission officials, they made an in-house review to analyze the implementation problems. However, according to Handbook 3, a final evaluation is required when follow-up activities are anticipated. After this project ended, several other private enterprise projects were initiated.

Close-out Reports

According to USAID Handbook 3, Chapter 12, a Project Assistance Completion Report is required to be prepared within six months after completion. However, a Completion Report was not prepared for the Private Enterprise Promotion project. The Water Supply and Sanitation project did identify the need for additional assistance. But, the Mahaweli Basin Development project's Completion Report did not directly address project sustainability or the need to continue monitoring activities for the project.

The Project Activity Completion Report for the Water Supply and Sanitation project contained a comparison of the planned outputs and the actual outputs achieved. Furthermore, this Report identified the need to continue monitoring the project and USAID/Sri Lanka transferred \$400,000 to a centrally funded project. Under this centrally funded project, a final report on institutional strengthening was prepared in January 1994 by the technical assistance contractor. Project sustainability concerns were addressed in this report. This follow-up assistance helped to ensure the continuation of project benefits.

The Completion Report for the Mahaweli Basin Development project did not explicitly address project sustainability. Nor did it address a need for post project monitoring, although two additional projects were initiated to address follow-up activities. According to Handbook 3, Chapter 14, an important element of the close-out report is recommendations for continuing USAID support and monitoring actions.

* * * * *

Evaluations should be designed to answer whether the effects of the project are likely to be sustained after USAID funding stops. However, only one of the three projects sampled addressed the question of sustainability in the evaluation reports. In addition, only one of the three projects sampled directly addressed sustaining project benefits in the Project Assistance Completion Report. As identified in Chapter 14 of Handbook 3, recommendations are an important element of the Completion Report in continuing USAID support and/or monitoring those projects where USAID has a long-term interest.

In sum, USAID/Sri Lanka could increase the likelihood of implementing projects with sustaining benefits by assessing project sustainability during interim evaluations. The Mission could also increase the long-term impact of projects by directly addressing project sustainability in its final evaluations and close-out reports.

Management Comments and Our Evaluation

The Mission concurred with recommendation 2.1 and said that recommendation 2.2 was essentially implemented. In 1993, the Mission established procedures to ensure that close-out reports specifically consider project sustainability, not only from the financial perspective but also in terms of environmental impact, as well as taking into account the lessons learned and follow-up activities.

The Mission pointed out that the Close-out Report for the Water Supply and Sanitation Project included comments relating to post-project monitoring. Therefore, we adjusted the report to reflect this fact.

Recommendations 2.1 and 2.2 are resolved upon issuance of this report. Since the Mission has begun to address project sustainability in its interim evaluation reports, recommendation 2.1 is closed. Recommendation 2.2

can be closed after the Mission provides us a copy of the "check list" that it used when preparing project close-out reports.

SCOPE AND METHODOLOGY

Scope

The Office of the Regional Inspector General for Audit, Singapore audited the sustainability of USAID-funded projects in Sri Lanka. We made the audit in accordance with generally accepted government auditing standards at the office of USAID/Sri Lanka in Colombo from February 14, 1994 to May 13, 1994. We also visited various locations in Sri Lanka for three completed projects.

The audit covered projects that were completed between January 1, 1990 to December 31, 1992 and new projects started during 1992 and 1993. Seven projects with expenditures of \$155.7 million were completed from 1990 through 1992 and three of these projects with expenditures of \$118.6 were sampled. These three projects were: Mahaweli Basin Development Phase II, Private Enterprise Promotion, and Water Supply and Sanitation Sector. The Water Supply and Sanitation Sector project was identified by the Mission as its most sustainable project. USAID/Sri Lanka started only two projects during 1992 and 1993, and both of these projects were covered. The two new projects—Agro-Enterprises and Promotion of Private Infrastructure—had obligations of \$9.3 million and expenditures of \$4 million as of December 31, 1993.

The audit determined if completed USAID/Sri Lanka-financed projects were still producing sustainable benefits. In addition, the audit determined if USAID-funded projects in Sri Lanka were designed to sustain project benefits and whether project evaluations and close-out reports addressed sustainability. In answering the audit objectives, we tested whether USAID/Sri Lanka followed applicable internal controls and complied with certain legal requirements. We also included steps to detect abuse or illegal acts which could affect the audit objectives. Mission management provided written representations which we considered essential to answering the audit objectives and assessing internal controls and compliance. For

problem areas, we did additional work to identify the cause and effect of the problem, and made recommendations to correct the problem and the cause.

We did not verify Sri Lanka's contributions to the projects.

Methodology

The methodology for each audit objective is discussed below:

Objective One

This objective is to determine whether USAID/Sri Lanka-financed projects continued to produce benefits after funding ceased and if so, what were the factors which continued to sustain those benefits. We identified the sustained benefits and analyzed the benefits for three completed projects. We interviewed Project Officers, host country officials (stakeholders), and project beneficiaries. In addition, we reviewed USAID's Center for Development Information and Evaluation publications, annual reports, impact reports, and various project related documentation.

Objective Two

To determine whether USAID designed sustainability into projects, we reviewed project development documents for three completed and two new projects. To accomplish this objective, we reviewed the four primary project design documents:

- New Project Description,
- Project Identification Document,
- Project Paper; and,
- Project Agreement.

We reviewed USAID Handbook 3, Chapters 1 through 6, USAID Policies in Handbook 1, and the Foreign Assistance Act of 1961, as amended to identify any legal and policy issues relating to sustaining project benefits. We analyzed the design documents to determine if the projects included

elements to sustain benefits. We discussed design issues with Mission officials and stakeholders.

Objective Three

To determine whether USAID/Sri Lanka addressed sustainability in project evaluations and close-out reports, we reviewed interim and final evaluations, host country contributions, and close-out reports for three completed projects. We reviewed USAID Handbook 3, Chapters 12 and 14, Mission Orders, and Section 110a of the Foreign Assistance Act, as amended, to identify legal and policy issues related to project sustainability. We analyzed the planned project outputs with the achieved outputs. We also discussed project benefits with Mission officials, project beneficiaries, and Sri Lankan officials.



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November 21, 1994

Mr. Richard C. Thabet
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Response to the Draft Audit Report of Project Sustainability
for USAID/Sri Lanka

Dear Mr. Thabet:

Reference: Your memorandum dated September 16, 1994, on the above subject.

USAID/Sri Lanka is committed to ensuring the sustainability of the project benefits of our investments. However, "sustainability" is still subject to various interpretations, both within USAID as well as among the larger development community. As a result, as noted on page 18 of your draft, the standards for measuring sustainability are not always clear and can vary significantly among different types of projects. This was not an easy area to audit. Overall we congratulate the auditors on the quality of the final report.

We have already initiated actions so as to get even better sustainability results. Our most recent project design for the Citizens Participation Project includes a separate section describing how "sustainability" issues will be addressed. Our evaluation scopes of work for two new mid-term evaluations include special reference to ascertain how project benefits will be sustained beyond the life-of-project. Likewise, since 1993, all our project completion reports have included sustainability measures related to future financing, environmental impacts, and follow-on activities. We trust these actions will permit the resolution and closure of both audit recommendations at the Mission level, upon issuance of the final report. We suggest that RIG direct audit recommendation number 1 (design sustainability into projects) to USAID/Washington.

USAID's response to the draft audit report and each of its audit objectives are outlined below. We are also forwarding, herewith, the Representation Letter, dated November 14, 1994.

1. Mission Response to Executive Summary:

The Executive Summary, in general, presents an accurate picture of the audit. However, as pointed out in our specific comments below, we think that the issue of the economic impact of the Mahaweli Basin Project needs to be qualified. We would suggest wording to the effect that: " However, the full economic benefits anticipated by the project have yet to be realized." (See section below for more details)

2. Mission Response to Audit Objective No. 1 - Did USAID/Sri Lanka-financed projects continue to produce benefits after USAID funding ceased, and if so, what were the factors which contributed to sustaining those benefits?

While we generally agree with the analytical framework established on page 5 of the audit, clearly the questions outlined for the Mahaweli Agriculture and Rural Development Project should not be used for all projects. For example, the construction component of the Mahaweli Basin Project emphasized sustaining different benefits from the Private Enterprise Promotion Project. As you noted on page 18 of the audit report, "Due to these different benefit flows, it would not be feasible to assess sustainability of different projects based on a single set of criteria".

Therefore, we believe the Table included on page 6 is an oversimplification in that it affords the same weight to each indicator among dissimilar projects. As such, the conclusion at the end of that section on page 6 should point out that the Water and Sanitation Project resulted in the most benefits. The impression should not be left that unless all indicators were achieved, the other projects were not sustainable nor successful.

Mahaweli Basin Development Phase II

The breadth, complexity and multi-project nature of USAID's nearly \$200 million investment in the Mahaweli present special difficulties in ascertaining the sustainability of any one activity. While the Mahaweli Basin Development II Project, which constructed 125 kilometers of irrigation canal, was the largest single activity, its ultimate sustainability has always been tied to subsequent agricultural and production investments, by the GSL and donors (including USAID), some of which are still ongoing.

We were surprised that the audit did not, as per the terms of reference, describe the continuing project benefits in the form of adequate water supplies, canal maintenance, and the improved performance of GSL institutions managing irrigation in System B. These benefits are visible evidence of the project's sustainability, are over six years old and still going strong. The audit is correct in pointing out that water fees were never introduced. However, more needs to be said. Our projects have successfully introduced "cost recovery" mechanisms for financing irrigation by way of turning whole parts of the distributery system over to private farmers.

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The audit conclusion that "we question whether USAID's investment in the (MBD) project was economically or financially justified" needs to be qualified. First, the economic and financial analyses are far beyond the scope of this audit and its level of inquiry. For example, there are numerous non-farm income benefits that need to be included and a whole range of other social benefits that should be estimated to obtain a final economic return figure. Most importantly, not all the information is in yet: large numbers of new families are still moving into the System B area. Likewise many of the projects benefits extend beyond the geographical limits of System B into other areas of the Mahaweli. At best, the audit can say that, to date, not all of the benefits anticipated have been achieved.

Private Enterprise Promotion Project

The Private Enterprise Promotion (PEP) Project represented USAID/Sri Lanka's first major effort aimed at private sector development in Sri Lanka. In this context, the project was, by its very nature, experimental in its approach. It pioneered direct donor assistance to private sector firms for training and investment promotion organizations. Perhaps more importantly, it capitalized on the positive "lessons learned," and provided a foundation for several subsequent Mission investments including the Private Sector Policy Support, Mahaweli Enterprise Development, and Technology Initiative for the Private Sector projects. Each of these have proven to be very successful.

Perhaps more importantly, the PEP project was catalytic in moving the Socialist Republic of Sri Lanka to adopt public policies favorable to private sector participation in the economy. The subsequent privatization programs and liberalization measures have been instrumental in increasing the country's economic growth and generating financing for sustainable long term growth.

The audit report notes that the project did not achieve its stated impact and suggests that the Sri Lankan Business Development Center's (SLBDC) future financial viability is questionable. We don't believe this is the case. Despite the fact that USAID funding ended five years ago, the SLBDC continues to train large numbers of Sri Lankans (1,329 in 1993) as well as to provide service important business clientele. While other donors currently provide program funding for the Center, all administrative funding is generated by fee-for service training activities. Thus, using the definition for financial benefits on page 5 of the report, the SLBDC has "a source of funds to cover operations and maintenance of the activity." Furthermore, we question the implication of the report that donor funding represents a financial weakness of SLBDC. It is, after all, a non-profit training institution. Like many other training institutions worldwide, SLBDC can legitimately seek funding from outside public and private sources.

We believe the comment on page 13 attributed to a SLBDC official that it "would not be able to continue its training program without donations" is somewhat questionable, since the official would obviously like USAID to provide new funding for the SLBDC - this in spite of the fact that it continues to survive without USAID funding.

3. Mission Response to Audit Objective No. 2 - Did USAID/Sri Lanka design Sustainability into Projects?

On page 14, the audit states that "the Mission did not define the benefits to be sustained or develop a strategy to help ensure that the benefits are sustained." We believe this misrepresents the actual situation. The USAID requirement to specify "End of Project Status" accomplishments has always, by implication, been considered to have the purpose of continuing benefits (i.e. continuing institutions, improved services, maintenance of strengthened policies etc). It might be more useful to say, "the lack of specificity in the definition of terms of describing sustainable benefits handicaps the Mission's ability to ensure that these benefits are sustained after the project is over."

With respect to Recommendation Number, 1.1 and 1.2, the Mission is incorporating more sustainability measures in our project designs. We have established new Mission-based standards for addressing sustainability in our projects. We are submitting the relevant sections from our latest design of the Citizens' Participation Project Paper as evidence.

This responds to the issues raised in the audit and represents our support for the recommendations and should suffice for action to resolve and close Recommendation 1.1 and 1.2 as now written. We would urge, however, that in the final audit report RIG consider directing this recommendation to USAID/Washington. It is clearly an Agency-wide issue that requires some measure of standardization among Missions.

In the sections on page 17-18, we have several comments. First, there seems to be some confusion with respect to our mutual understanding of "goals and purposes" in a USAID project. Our use of the term "Project Goal" is something larger than the USAID project to which our assistance contributes. It is the "big picture" result which we will help achieve. It is an independent variable. By definition then, our Promotion of Private Infrastructure project was never expected to meet all of the requirements of the project goal. It is instead, fully responsible for achieving the project purpose, i.e. "to assist the GSL to develop a market for private financing and management of economic infrastructure". We have established targets for measuring these sustainable benefits in the Project Paper. We do not argue the fact that more definition may be needed, but the second paragraph on page 18 misses the point in helping say how that should be done.

In the section concerning how benefits will be sustained on pages 19-20, we agree that continued financing is a major post-project sustainability issue. However, we believe your case for an "exit strategy" would be strengthened by including references to other important issues such as a favorable policy environment, institutional effectiveness, and appropriate consideration for improving technologies. While it is possible to have a notion of what an exit strategy might look like in the project design, it is likely to be a more productive issue at the first evaluation. This was, in fact, the case with last year's interim evaluation of the Technology Initiative for the Private Sector Project (TIPS), which involved substantive sections on how the Mission could develop an "exit strategy" for the project.

4. Mission Response to Audit Objective No. 3 - Did USAID/Sri Lanka address sustainability in project evaluations and close-out reports?

Recommendation No. 2: We recommend that USAID/Sri Lanka:

- 2.1 assess project sustainability in the interim evaluations; and**
- 2.2 ensure that final evaluations and close-out reports determine if project benefits were achieved and the actions that can be taken to sustain these benefits.**

We concur with Recommendation 2.1 that project sustainability needs to be assessed at interim evaluations. It is indeed Agency policy (A.I.D. Evaluation Handbook, April 1987, P.23) to include an assessment of sustainability in project evaluations. Furthermore, the Mission is already using a set of guidelines, which stipulates the need to assess project sustainability at interim evaluations. The most recent interim evaluations include this requirement (please refer to page 9 of attachment 2). Also we herewith attach a copy of the special sustainability assessment done on the Mahaweli Enterprise Development Project (see attachment 3).

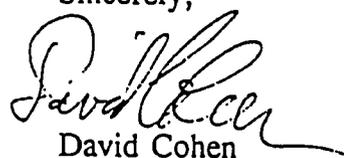
Contrary to the statement on page 26 in the audit, the WS&SS project closeout report mentioned post-project monitoring as follows:

"USAID has already transferred US \$400,000 to central funded WASH contract to extend the Technical Assistance for another year after PACD. Under this extended TA, WASH would help NWSDB to strengthen institutional development monitoring and feedback activities to sustain the benefits gained under WS&SS project".

With respect to Recommendation 2.2, since the beginning of 1993, the Mission has ensured that closeout reports specifically consider project sustainability, not only from the financial perspective but also in terms of environmental impact, as well as taking into account the lessons learned and follow-on activities. We have already used this check list to monitor sustainability on the Diversified Agriculture Research Project, the Mahaweli Downstream Support Project, the Mahaweli Enterprise Project, and the Irrigation Systems Management Project. As evidence attachments 4 - 9 provide extracts of the final evaluations and closeout reports, where sustainability is addressed in detail.

Based on the above, Mission requests that recommendation No. 2.1 and 2.2 be resolved and closed on issuance of the final audit report.

Sincerely,


David Cohen
Director

List of attachments:

1. Extracts from CIPART (383-0119) Project Paper
2. Terms of Reference for the PPI (383-0118) Mid-Term Evaluation
3. MED (383-0090) Sustainability Assessment Report
4. Extracts from the APAP (383-0083) Final Evaluation Report
5. Extracts from the DARP (383-0058) Final Evaluation Report
6. Extracts from the DARP (383-0058) Close-Out Report
7. Extracts from the MDS (383-0103) Close-Out Report
8. Extracts from the MEP (383-0075) Close-Out Report
9. Extracts from the ISMP (383-0080) Close-Out Report
10. Representation Letter



UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
MISSION TO SRI LANKA.

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May 16, 1994

Mr. Richard C. Thabet
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Dear Mr. Thabet:

You have asked that the Mission Director for USAID/Sri Lanka provide a Representation Letter in connection with your audit of project sustainability for USAID/Sri Lanka. Your staff has informed us that two audit universes were identified--projects completed during the period from January 1, 1990 to December 31, 1992 and projects started during the period from January 1, 1992 to December 31, 1993. The seven completed projects identified had obligations and expenditures of \$155.7 million. Also, two new projects were identified with obligations of \$9.3 million and expenditures of 3.9 million. The audit was intended to answer the following audit objectives.

- * Did USAID/Sri Lanka's projects continue to produce benefits after USAID funding ceased?
- * Did USAID/Sri Lanka design sustainability into its projects?
- * Did USAID/Sri Lanka follow USAID policies and procedures to address sustainability in project evaluations and close-outs?

I have been assigned as the Mission Director for Sri Lanka since January 1994 and accordingly was not personally involved before that time with the implementation of the activities audited. Based on the representations made to me by my staff and their written concurrence with representations made herein, I confirm the following representations with respect to these aspects of the audited construction activities which were under the full control of USAID/Sri Lanka:

1. For the projects under audit or active during the audit period, USAID/Sri Lanka is responsible for a) its internal control system; b) its compliance with applicable U.S. laws, regulations, project agreements and contract terms; and c) the fairness and accuracy of its accounting and management information.
2. To the best of my knowledge and belief, USAID/Sri Lanka has made available to RIG/A/Singapore auditors all the financial and management information related to the activities audited.

3. To the best of my knowledge and belief, USAID/Sri Lanka's records relating to the activities audited are accurate and complete and give a fair representation as to the status of the activities audited.
4. To the best of my knowledge and belief, USAID/Sri Lanka is not aware of any instances which we consider material where financial or management information directly relating to this audit has not been properly and accurately recorded and reported, other than the findings in the report.
5. To the best of my knowledge and belief, USAID/Sri Lanka has disclosed any known irregularities related to the projects which we consider substantive involving USAID/Sri Lanka employees with internal control responsibilities or other organizations responsible for the activities audited. For the purposes of this representation, "irregularities" means the intentional noncompliance with applicable laws or regulations and/or material misstatements, omissions or failures to disclose.
6. To the best of my knowledge and belief, USAID/Sri Lanka is not aware of any instance (other than what has been included in the draft audit report or reported by USAID/Sri Lanka during the course of the audit) which we consider material, where there has been noncompliance with USAID policies and procedures or violation of U.S. law or regulations.
7. After review of your draft audit report and further consultation with my staff, I know of no other facts as of the date of this letter (other than those expressed in our Management Comments to the draft report) which, to the best of my knowledge and belief, would materially alter the conclusions reached in the draft report.

I request that this representation letter be considered a part of the official USAID/Sri Lanka comments on the draft report, and that it be published as an annex to the final report.

Date: 5/27/94


David Cohen
Mission Director
USAID/Sri Lanka