



CONSERVATION  
INTERNATIONAL

4 August 2006

*Management Response*

*Independent Review Terminal Evaluation (July 2006) on the Milne Bay Marine Program*

In this *Management Response* we provide corrections and clarifications with regard to Conservation International's management and execution of the Milne Bay Community-based Coastal and Marine Conservation Project.

Overall, CI agrees with the report's assertion that the project is worthy (p. iii), and that it has suffered from insufficient oversight from the Steering Committee, UNDP, and CI (p. iii). However, we believe the report reaches unsupported, and in many cases, erroneous conclusions. Many of these issues could have been quickly clarified had the review team contacted and queried the relevant staff in CI-Headquarters in Washington, DC.

In particular, we would suggest the following re-interpretations of those statements that inappropriately put CI's work in an unfavorable light:

**PROGRAM AND MANAGEMENT**

Engaging Milne Bay Provincial Government (p. iii). CI acknowledges the need to improve engagement with the provincial government, and will be working diligently in the remaining period of Phase One to fully engage and build capacity in order to foster the transition of the marine initiative into a government-management activity.

Work on Output 2 (network of MPAs) (p. iii). CI disputes the statement "there is yet no network" and suggests there is, indeed, the beginning of a strong network in Zone One, as evidenced by the signing of 8 agreements with landowning groups.

Effectiveness of monitoring and evaluation (p. v). CI agrees that it must improve its project monitoring and annual evaluation of progress against a clear set of indicators. This will be effected through the implementation of CI's planning database that has been established in Microsoft Access.

CTA Response to the Interim Report. (p. 4). The CTA submitted a 47-page response to the 17-page interim report on behalf of the Project Team. This response was not seen or reviewed by CI staff, and contains divisive and inflammatory allegations which are inaccurate and inconsistent with financial records.

Repair and Recovery Action Plan (p. 4). CI welcomes the reviewers' suggestions for improving the implementation of the Project over the remainder of Phase One. CI believes this to be a very useful component of this terminal evaluation.

...poor management by CI (p. 11). CI would dispute the all-encompassing nature of the statement on line 7 of page 11. Yes, there were problems, but CI had in place controls that work well under typical conditions with standard collaborative leadership. The unusual nature of the project leadership in Milne Bay made it impossible for CI's standard controls to work effectively.

...poor relationship with provincial government (p. 11, line 8). CI disputes that it had poor relations with Milne Bay officialdom. Throughout the planning and inception phase CI's PNG leadership maintained good working relations with the Government. CI suspects that project senior leadership undermined this once it took full command over the Project.

Project failure to work productively with Provincial Government (p. 12). This is an important failure of the Project, and CI should have seen to it that this liaison and engagement with government was continued and expanded.

Small island vulnerability indices....(p. 24). CI contests ANU's statement that CI has been slow to contract ANU. In fact, ANU has been slow in implementing its activities. ANU has never spent-out its entire grant from CI. Even today, ANU has reported that it has funds on hand to continue its work (while requesting additional funds for future work).

Tenure, genealogy, disputes... (p. 25). CI agrees with the evaluators that CI should not get intimately involved in genealogical analysis and dispute resolution. These should be conducted internally by communities, with CI only acting as a facilitator to the process.

Fisheries and FADs (p. 26-27). CI agrees that additional study and analysis of the social and fisheries impacts of FADs is required before expanding their deployment in Milne Bay.

Annex 8 Project Recovery. CI agrees that the suggestions within Annex 8 are a useful starting point for the transition of the Project to a final leg of Phase I and a preparation for a possible Phase II of the project, to be managed by the Milne Bay Provincial Government with technical support by CI.

Annex 10. CI believes the Project needs to re-examine the nature of its genealogical mapping within the Milne Bay context, to make certain that such activities help bind communities; to ensure that the process is community-led; to ensure that local governance is fostered through this activity; and to avoid involving CI in a dispute resolution process.

## **FINANCIAL MANAGEMENT SYSTEMS**

The evaluation report makes serious and inaccurate allegations of financial mismanagement. In gathering information for their evaluation, the evaluators drew information from individuals working at the project site that lacked an understanding of CI's financial systems and structure and thereby drew conclusions based on incomplete information; from poor-quality independent audits in which the auditors did not develop a full understanding of our financial systems and thus audited only a portion of the projects finances; and from a CTA who from the start of his tenure showed resistance to operating within CI's procedural framework and accepting guidance from DC management. While we will agree that there is room for debate as to whether some of the project funds could have been spent more efficiently, we unequivocally deny the charges of financial impropriety made by the evaluators. These misconceptions and allegations have for too long plagued the project, and CI would welcome a thorough project audit that encompassed Alotau, Port Moresby and the DC headquarters in order that a full picture of the project may be ascertained and these misconceptions and allegations may finally be laid to rest.

Conservation International uses Oracle Financial Applications to track expenses. Oracle is a web-based system which is available to all CI offices. Each CI office maintains its own set of books in local currency within Oracle. These sets of books are translated and consolidated into a Worldwide consolidated set of books on a monthly basis. The financial reports to the UNDP are based on the Worldwide consolidated set of books, which in this case includes transactions from the Papua New Guinea (PNG) set of books (Alotau and Port Moresby operating units) and the US set of books. Initially, all PNG transactions were recorded into QuickBooks, and then uploaded into Oracle. As of 2004, all PNG transactions were recorded directly into Oracle. Whether uploaded or entered directly, all transactions for this project have been recorded in Oracle since inception.

CI could not, as the UNDP originally requested, adopt the UNDP Chart of Account, but it has been able to track and report its sources and uses of funds in the format provided by the UNDP. Additional confusion may have occurred when the UNDP changed its accounting system and didn't revise CI's budget to include the new nomenclature. CI's Chart of Accounts is set up to track transactions beyond the basic natural accounts. The Milne Bay Marine initiative has a unique "cost center" code, the sources and uses of funds are tracked by unique "donor" codes, and the outcomes and the strategies are also assigned unique codes. Consequently, the GEF, TRAC/JHDTF and CI parallel funds have been assigned unique codes and are tracked accordingly.

CI has had difficulties recruiting and retaining qualified and experienced finance staff in PNG. The first Finance and Administrative Manager for the project was not hired until the first quarter of 2004, and over the next two years, CI experienced turnover, losing two other project finance staff and administrative managers. These circumstances have made it difficult for CI to build financial management capacity in the Alotau office, but each Finance and Administration Manager for the project has been trained and has had access

to all the transactions pertaining to the project, including transactions recorded in Port Moresby and Washington.

Although the evaluation report states that “the evaluation team skills do not include forensic accountancy”, the report contains specific assertions regarding accounting and financial management of the project. Further, this information was gathered at the project site, without consultation or verification with key financial staff at CI – Headquarters, and much of it is inconsistent with CI financial records, which have been reconciled against the funds awarded by the donors. Had the evaluation team consulted with appropriate staff, we believe the accuracy of the report could have been significantly improved.

### **Financial Reports**

While it is true that CI did not submit a financial report to the UNDP until April 2004, there were extenuating circumstances. Although the agreement was signed in November 2002, Project activities did not start right away and expenditures for this Project were not recorded against the GEF/TRAC/JHDT funds until June 2003. Discussions between CI and UNDP as to the appropriate coding of these expenses further delaying the submission of the first financial reports. CI made every effort after that to submit financial reports by the required deadline. However, CI operates on a July-June fiscal year and the 2<sup>nd</sup> quarter financial reports for 2004 and 2005 were delayed by its annual audits.

### **Disbursements**

Other than expatriate staff salaries and benefits paid out of Washington, and PNG staff salaries paid out of Port Moresby, the overwhelming majority of Project expenses were incurred and disbursed in Alotau. In an effort to better monitor the Project expenditures, CI has recently consolidated its financial operations and is now processing all payments from Port Moresby.

As stated above, the financial transactions for this project have been recorded in Oracle from inception. Financial records were and are available to the Project finance manager(s) in Alotau.

<b>Project Expenses Disbursed/Expensed from Washington</b>	<b>GEF</b>	<b>TRAC/JHDTF</b>	<b>Total</b>
Expatriate Salaries & Benefits (P. Mackay & M. Kristensen)	243,658	0	243,658
Other Direct Project Costs	20,443	0	20,443
Sub-agreements (Australian National University)	0	183,334	183,334
NGO Execution Fee/Management Fee	280,527	28,973	309,500
	<b>544,628</b>	<b>212,307</b>	<b>756,935</b>

### **NGO Execution Fee/Management Fee**

CI refutes the evaluations team's assertion that CI overcharged the project by \$400,000 in execution fees and overhead costs.. .

As of 31 March 2006, the NGO execution fees billed to the UNDP were \$280,527 for GEF and \$28,973 for TRAC/JHDTF for a total of \$309,500 against a total budget of \$314,428 .

CI's approved budget included an NGO Execution/Management Fee of 10% of direct costs which was intended to cover the project's share of CI's core administrative costs. CI's audited indirect cost/overhead recovery rate, which covers actual general and administrative expenses such as executive management costs, accounting and audit services, human resources, communications activities, organizational insurance, etc, was 22% at the time this agreement was signed. This rate is consistent with those of similar international non-profit organizations headquartered in the US or Europe. Because of its commitment to the Project, CI agreed to accept a lower indirect cost recovery rate/management fee. CI has used the \$309,500 it recovered in NGO Execution/Management Fees to offset a portion of its indirect costs (detailed above) incurred in support of the Project. Additionally, CI included no indirect costs in the reported matching expenses. Thus, CI absorbed \$349,892 of unrecovered indirect costs on GEF funds, \$125,476 in unrecovered indirect costs on TRAC/JHDTF funds and \$327,379 in unrecovered indirect costs on matching funds for a total subsidy to the project of \$802,747.

At no time were any Washington or Port Moresby direct management support costs of the project charged to the GEF or TRAC/JHDT funds or applied against the NGO Execution Fee/Management Fee. Costs incurred by Washington and Port Moresby in direct management oversight of the project were charged to other CI funds and counted towards the parallel funding requirement. As of March 31, 2006, the direct DC and Port Moresby management support cost represented only \$187,426 out of a total of \$1,488,085 in Parallel Funding provided to the project by CI through March 31, 2006 (see table below).

<b>CI Parallel Funding through 1st Quarter 2006</b>			
	<b>Total Direct DC &amp; POM Management Support</b>	<b>Direct Milne Bay Project Expenditures</b>	<b>Total CI Parallel Funding</b>
<b>CY03</b>	56,901	170,478	227,379
<b>CY04</b>	62,743	111,962	174,705
<b>CY05</b>	53,247	357,658	410,905
<b>CY06 (1st Qtr)</b>	14,535	660,561	675,096
<b>Total</b>	<b>187,426</b>	<b>1,300,659</b>	<b>1,488,085</b>
<b>Total Budgeted CI Parallel Funding per Prodoc</b>			<b>1,366,381</b>
<b>Additional CI Parallel Funding as of March 31, 2006</b>			<b>121,704</b>

The Parallel Funding reports through December 31, 2005 were approved by the UNDP in a meeting with CI in February 2006. As the table above shows, CI will have by far exceeded its Parallel Funding requirements by the time the Project ends. Further, we have continued to support the project through matching costs in the second quarter of 2006, thus further exceeding the matching requirements of the agreement.

### **PNG Income Taxes and Hypothetical US Taxes for Expatriates**

CI disagrees with the evaluation team assertion that it wasted \$200,799 in income tax for the expatriates working on this Project. CI is required by law to pay taxes in PNG. Our current company registration does not include tax free status for international staff and at no time did CI make any such representation to the UNDP prior to signing the agreement.

International tax issues are very complex and CI contracted professional tax experts (AWR and KPMG/PNG) to calculate the expatriate taxes owed to the PNG Government, and based on those recommendations, remitted the appropriate amounts.

Additionally, CI has adopted the practice of “tax equalization” to ensure that international assignees do not pay more income tax as a result of their international assignment than they would if they had worked in the organization’s home office. CI thus withheld from the expatriate staff salaries the taxes they would have owed had they worked in DC. CI withheld \$100,634 from the expatriate salaries and has paid \$100,165 in local taxes on their behalf. The \$469 difference was credited back to the project. The fact that the salaries and withholding taxes were recorded in the DC books while the tax payments

were recorded in the PNG books possibly contributed to the confusion about these transactions. The allegation of overcharging of staff remunerations costs is not factually based or supported by any financial records. Again these issues could have been clarified had the evaluation team met contacted or discussed with financial staff in Washington, DC.

### **Work Permits for Expatriates**

CI has a policy to hire local nationals to the extent possible and did not, therefore, have much experience or expertise in securing work permits for international staff in PNG. The short-term business visas were meant to be a stop gap measure to address the urgency expressed by the UNDP to get the project underway, CI sought the advice of professional experts, but the process of obtaining work permit visas for expatriates proved to be very lengthy and difficult.

### **Counseling Services**

This cost appears to be an activity initiated by the CTA and not included in the approved work plan.

### **Bathymetry/Seabed Mapping**

This was included in the original work plan budget.

### **Training**

This training option was convenient but perhaps expensive. The Project should have bid out this work.

### **Travel Expenses**

The evaluation team erroneously labels all travel related expenses "Staff Travel" when in fact the \$755,000 in travel related expenses incurred during 2004 and 2005 includes travel related expenses such as survey participant travel costs, survey boat rentals, and per diems for the village engagement teams.

### **VET Patrols**

We presume this accounts for all costs related to these patrols, including VET compensation (as VETs were not CI employees. Given that the VET activities were fundamental to the engagement of the key target communities over a four million hectare zone, we believe this cost is reasonable.

## **CI MANAGEMENT AND INVESTMENT IN 2006-2007**

CI continues to invest in this project and its staff. CI has a program budget in place that will continue providing funds to the Project into calendar year 2007. CI is actively seeking additional funds to ensure all Phase One conservation outcomes are reached.

## **SUMMARY RESPONSE**

CI has developed complex field conservation projects around the world, and nearly all of these are well-received and highly successful. Only when there are extraordinary and extenuating circumstances does CI find itself receiving the kind of criticism that has been leveled at CI in this Milne Bay situation. The Milne Bay situation was unique. CI intends to learn from the experience, and intends to continuing to work in Milne Bay to benefit biodiversity and local communities.