

**Independent Evaluation
of
The Arannayk Foundation
and
The Tropical Forest Conservation Fund**

Draft Report – November 2008

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Acronyms and Abbreviations

AF	Arannayk Foundation
AoA	Articles of Association
BDT	Bangladesh Taka
BFRI	Bangladesh Forest Research Institute
CAMEL	Credit Asset Management Equity Liability
CBO	Community Based Organizations
CFSD	Centre for Sustainable Development
CODEC	Community Development Centre
EAI	Enterprise for the Americas Initiative
ECB	Environment Council of Bangladesh
ERD	Economic Relations Division (Ministry of Finance)
FD	Forest Department
FDR	Fixed Deposit Receipt
FSC	Finance Standing Committee
GOB	Government of Bangladesh
IDO	Integrated Development Organization
IFESCU	Institute of Forestry and Environmental Sciences, Chittagong University
IUCN	International Union for the Conservation of Nature
METI	Management and Engineering Technologies International
MoA	Memorandum of Association
MOEF	Ministry of Environment and Forests
NGO	Non-governmental Organization
OSAD	Organization for Social Action and Development
OSC	Operations Standing Committee
PIPET	Project Implementation Proposal Evaluation Tool
PPET	Project Proposal Evaluation Tool
PSC	Program Standing Committee
RedLAC	Red de Fondos Ambientales de Latinoamerica y el Caribe
TFCA	Tropical Forest Conservation Act
TFCF	Tropical Forest Conservation Fund
USAID	United States Agency for International Development
USG	United States Government

Financial Year of the Arannayk Foundation

July 1 to June 30

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I. Executive Summary

The Tropical Forest Conservation Fund and the Arannayk Foundation

1.01 Bangladesh was the first country to take advantage of provisions of the U.S. Tropical Forest Conservation Act (TFCA) of 1998 that provided eligible countries intent on conserving or restoring their tropical forests the opportunity to reduce bilateral concessional debt owed to the United States.

1.02 The Bangladesh Tropical Forest Conservation Fund (TFCF) was created pursuant to an agreement between the Governments of Bangladesh and the United States to forgive outstanding debt related to the sale of agricultural commodities in return for payment of US\$ 8.5 million in interest payments to an independent entity charged with using those funds for the purpose of conserving tropical forests in Bangladesh. The entity, the Arannayk Foundation, is an independent corporate body whose purpose is to provide financial and other support for activities that will preserve and protect the tropical forests and biodiversity assets of Bangladesh. It was registered in July 2003 under the Bangladesh Companies Act as a not-for-profit company limited by guarantee and not having a share capital. The objects of the Foundation, as set out in its Memorandum of Association, are numerous, giving it comprehensive powers to manage the Tropical Forest Fund so as to achieve the Foundation's stated purpose.

Purpose of the Evaluation

1.03 A statutory requirement exists for the periodic evaluation of Funds created through the TFCA program. Accordingly, the U.S. Congress has an interest in the outcome of this evaluation. The broader audience for the evaluation findings includes the U.S. Agency for International Development (USAID), the U.S. Department of the Treasury, the U.S. Department of State, the U.S. Office of Management and Budget, the Enterprise for the Americas board, the greater family of Enterprise for the Americas Initiative (EAI) and TFCA Funds and other associations supporting environmental funds (e.g. RedLAC and the Conservation Finance Alliance).

1.04 Detailed terms of reference, attached as Annex I, were provided by the USAID housed Secretariat that supports the EAI and TFCA programs. In line with those terms of reference, the evaluation team reviewed:

- Compliance with TFCA legal agreements between the Government of Bangladesh (GOB) and the US Government (USG);
- Governance structures and their operation;
- The Foundation's general operational and grant making frameworks; and
- Actual and potential conservation impact.

This report presents the evaluation team's analysis of whether the Arannayk Foundation's governance structures, operating framework and business practices are designed in a way that will allow the Foundation to achieve its objective of tropical forest conservation.

Summary of Arannayk Foundation Operations

1.05 As of June 30, 2008 the Government of Bangladesh had transferred a total of BDT 357.8 million (US\$ 5.7 million) to the Tropical Forest Conservation Fund account of Arannayk. Cumulative investment earnings from financial years 2004/2005 through 2007/2008 were BDT 88.2 million (US\$ 1.3 million).

1.06 As of the same date, the Arannayk Board had approved 16 “projects” comprising 46 grants with a total value of BDT 205.9 million (US\$ 3 million). Twenty-seven grants grouped as one project were completed, 9 grants were under implementation, 3 grants were closed and 7 grants had not yet begun implementation. Grant disbursements as of June 30, 2008 totaled BDT 21.2 million (US\$ 0.31) for the BDT 51.1 million (US\$ 0.75) of grants completed, closed or under execution.

Key Conclusions

1.07 The Bangladesh Tropical Forest Conservation Fund was authorized in 2000 as the first TFCA fund established globally. As the first of its kind, the TFCF, and the Arannayk Foundation that manages it, encountered a three-year delay as the USG and GOB sought to reconcile Bangladesh law and the Tropical Forest Conservation Act. Once nominated, the Founding Board engaged an Executive Director and two senior staff, and put their early efforts into defining the policy and procedural framework for administration and grant-making. This framework is sound, and has allowed Arannayk to operate in compliance with its legal and regulatory obligations, and with relative efficiency and effectiveness. Prudent investment of funds has grown the TFCF by 23% in nominal terms, and assured a positive rate of return in real terms.

1.08 The Board’s operational focus in its first three years was the framing of “programs” to guide grant-making and the review of grant proposals. Little attention was given to strategies for fundraising and communications in the absence of a track record that could make Arannayk attractive to donors. With the arrival of a new Executive Director in early 2007, grant-making practice was upgraded to best-practice standards and field monitoring by Foundation staff became “hands on” and more frequent. Non-performing grants were closed, and measures introduced to support grant implementing entities, 95% of which are NGOs. Strategic changes have also been introduced to the pipeline of future grants. Early small pilot schemes incorporating income generating activities gave way in 2008 to larger projects supporting local community and Forest Department co-management of parks and reserved forests. The larger interventions will accelerate commitments and disbursements of the TFCF and launch the formal partnership with the Forest Department, which will become a grantee for the first time. These changes call for Arannayk to refine and focus its current grant-making programs into a coherent long-term strategy, develop a fundraising strategy to address the more rapid drawdown of the TFCF that will occur with larger projects and grants and define a supporting communications strategy to increase awareness of its contribution to conserving tropical forests both within and outside of Bangladesh.

1.09 The second three-year term of Arannayk’s five non-governmental Board Members will end in July 2009, and a substantively new Board will take the reins. All of the Founding Members

contributed to a steady and successful start-up phase which is now coming to an end. Despite the sound financial and administrative footing on which they leave the Foundation, they or their successors will need to give prompt attention to a number of key actions:

High Priority Recommendations

Governance

Immediately begin the process to identify the five new nongovernmental Board members. The GOB should indicate to the Board how it will proceed with the consultations that must precede nominations, and ensure that a transparent and well-documented process is followed. Allow new nominees to attend a few Board or Committee meetings before July 2009, to gain familiarity with Board work, processes and procedures.

Develop detailed procedures for the Board and use them to clarify the practical modalities for implementing the Articles

Act quickly, with support from USAID, to obtain the exemption that will clarify the Foundation's tax status. Concurrently, move forward with the audits for the three years 2005/2006 through 2007/2008.

Amend the AoA to introduce staggered terms for the nongovernmental Board members.

Amend Article 12 of the AoA to include legitimate causes other than malfeasance for removing a Director.

Take decisions by vote, rather than consensus, as required by the AoA. Record all decisions clearly in Board minutes.

Develop detailed Board procedures beyond the AoA to clarify the practical modalities of their implementation.

Ensure all responsibilities of the General Body are carried out in accordance with the AoA

Management and Administration

Prepare a formal Operating Manual that collects all key operating documents. Complete the manual with Board Procedures, an Investment Policy,

Adopt a streamlined procedure for the Board to rapidly consider and approve grants that address urgent or emergency situations.

Use the review of the Strategic and/or Financial Plans to obtain ex ante agreements in principle from the two Governments for grants exceeding the review threshold and other exceptional situations.

Financial Management

One new Board member should have financial expertise and, if possible, knowledge of financial risk management.

Engage the Fiscal Agent, or alternatively an investment adviser to review risks and, if necessary, suggest changes to current investment practice to address them and to guide investment decisions.

Prepare a written investment policy that clearly spells out objectives and practice, including the risks that should be weighed when decisions are made .

Act quickly, with support from USAID, to submit a formal request for tax exemption with the National Board of Revenue.

Concurrently with the request for tax exemption, move forward with the audits for the three years 2005/2006 through 2007/2008.

Strengthen the auditor's terms of reference for the grantee audits to require sufficient testing to be carried out in order to conclude that funds have been spent for intended purposes.

Strategic Direction and Outreach

Prepare an overarching Strategic Plan over the next few months, consulted appropriately and approved as a draft by the full Board. The final Strategic Plan should be approved for use only after review and approval by the incoming Board.

Support the Strategic Plan with a Financial Plan, and ensure that the two adequately justify the need for additional financing.

The new Board should develop a fundraising strategy in line with the overall Strategic Plan.

Create a Standing Committee dedicated to fundraising.

Empower the Executive Director by delegating fundraising responsibilities to him.

Fill the vacant position for a communications officer and integrate him/her into the various strategy discussions.

Prepare a communications strategy to market Arannayk's image, attract new partners and support fundraising efforts within and outside of Bangladesh.

Biodiversity Impact

Ensure proposals identify threats, baseline studies cover them and indicators are identified to monitor progress against the baseline.

Provide training and expert assistance to project implementing entities to help with baseline studies and identification of biodiversity conservation indicators.

II. Context

2.01 Bangladesh has a population of about 147 million people within a total land area of 147,570 km², making it the most densely populated country in the world. Its economy is based on agriculture, with about 75% of inhabitants living in rural areas. Estimated forest area is 2.5 million ha, or about 17.5% of total land mass.

2.02 Forests are under severe threat from years of land encroachment, unsustainable harvest of forest products and an acute shortage of biomass energy. Population growth, currently at 2% per annum, has been a driving factor of deforestation to meet the ever increasing need for living space and resources. Survival of forest-based biodiversity has been put in jeopardy after years of high population growth.

2.03 The pressures on natural forests and forest biodiversity were not substantively different in the late 1990's when the Governments of Bangladesh (GOB) and the United States (USG) initiated discussions for a reduction of debt to support conservation of tropical forests. . In 2000, the two parties reached agreement on the creation of a private foundation, with a majority civil society representation, as well as representation of the two governments. A broad mandates was conferred on the Foundation to complement and support the approach of the GOB Forest Department. The Arannayk Foundation was created in 2003 with a mission to promote sustainable management, conserve and restore natural forests, and US\$8.5 million to aid the recovery of what some view as Bangladesh's most valuable natural resource.

III. Evaluation Method and Approach

3.01 USAID contracted the Office of International Programs of the U.S. Forest Service to conduct an independent evaluation of the TFCA Fund administered by the Arannayk Foundation as required by the Tropical Forest Conservation Act. The US Forest Service used the services of Management and Engineering Technologies International, Inc. to engage the evaluation team. The team members contracted by METI included an international consultant (Kathleen Mikitin) and two consultants who are nationals of Bangladesh (Nishat Chowdhury and Salahdin Imam).

3.02 To collect information, the Evaluation Team used a combination of key informant interviews, site visits and review of extensive background documentation. The key informant interviews provided a 360-degree view of the Arannayk Foundation. Interviews were conducted with Government of Bangladesh officials, board members, Arannayk staff, recipients of grants with implementation responsibility and grant beneficiaries. Annex II provides a List of Persons Met. Annex III lists Documentation Reviewed.

3.03 The Evaluation Team reviewed the Arannayk Foundation's administration of the TFCA funds based on obligations of the bilateral agreements related to debt reduction and creation of the Tropical Forest Conservation Fund and Board, requirements of the Foundation's own Memorandum and Articles of Association, the TFCA Fund evaluation scorecard, recent studies that assess the

performance of conservation funds for the purpose of fostering best practice¹ and generally accepted principles of sound management.

3.04 The Evaluation Team dedicated two weeks to office and site visits to collect information and documentation, conduct interviews and develop preliminary observations. XX weeks were required to prepare the draft report, collect and analyze comments from reviewers and prepare a final version of the report.

IV. Observations and Recommendation

Compliance with Bilateral Agreements

4.01 The Government of Bangladesh has complied with its obligations under the Agreement between the Government of the United States of America and the Government of the People's Republic of Bangladesh regarding the Reduction of a Certain Debt Related to Agricultural Trade Owed to the Government of the United States and its Agencies, September 12, 2000 (2000 Debt Reduction Agreement). . Annex V: Debt Service Payments lists installments due through June 30, 2008 and payments made. All payments due have been made as required.

4.02 The Foundation is substantially compliant with the Agreement between the Government of the United States of America and the Government of the People's Republic of Bangladesh concerning the establishment of a Tropical Forest Fund and a Tropical Forest Conservation Board, September 12, 2000. Annex IV: Compliance with the Bilateral Agreement Establishing the TFCF, is a summary in matrix form of how the obligations set forth in that Agreement have been addressed in the Foundation's Articles, Board policy and procedural decisions and operating practices.

4.03 One area in which action is required for Arannayk's practices to be consistent with the Agreement is the submission of annual audits. In addition, Arannayk has not named a Fiscal Agent to carry out the tasks identified in the Agreement. The evaluation has concluded that the alternative actions taken by Arannayk are adequate at this time, but will need to be reviewed in the future if additional capital, especially capital held in a foreign currency, becomes available. The current situation and related recommendations are discussed in paragraphs 4.47 through 4.51.

Governance

4.04 Governing Framework. The Foundation's Memorandum of Association (MoA) and Articles of Association (AoA), both dated June 3, 2003, establish its governing framework. No changes have been made to either since they were issued. The Articles, which are equivalent to by laws, are generally considered to be adequate, but require clarification or possibly amendment to address the following: (1) Board Directors' terms are not staggered, which could weaken effective succession planning; (2) the means by which a Board decision is reached is not fully clear and (3) Board members can only be removed for malfeasance which limits the Board's ability to ensure its own effective operation. These issues are discussed in the paragraphs below.

¹ Principally, the Rapid Review of Conservation Trust Funds prepared for the Conservation Finance Alliance Working Group on Environmental Funds, May 2008 and the Conservation Trust Fund Investment Survey, Wildlife Conservation Society, June 2008.

4.05 Operating Documents. The Foundation does not have one formal operating manual, but does have Board approved policy and procedural documents that guide its daily operations and would be the key chapters of any operating manual. These include a Finance and Procurement Manual, Competitive Grant-Making Procedures, Terms of Reference for Board Committees, a draft Supervision, Monitoring and Evaluation Plan and a Personnel Policy. Suggestions are made throughout this report on complementary sections that should be added to the existing documents to complete an operating manual. The Board should approve the Operating Manual, once it is complete.

4.06 Board Composition. Arannayk's primary governing body is a seven member Board of Directors. *Two Directors, termed the Parties, are representatives of the Governments of Bangladesh and the United States.* Five Directors are drawn from non-governmental environmental, community, scientific and academic organizations that share an interest in forest conservation. Three of these Directors head their own organizations, and all five are highly respected experts in their fields. All were chosen on the basis of their competency, rather than affiliation, and, based on interview responses,² are committed to Arannayk's success.

4.07 In line with good practice, the Board has named three specialized committees (see Box 1) in the areas of finance, programs and operations. The Finance Committee has three members, and the other two have four members each. Each Standing Committee has terms of reference to guide its work. While the initial aim of the Standing Committees was to lay the groundwork to operationalize the Foundation, they also have ongoing responsibilities for review of investments, budgets, programs, work plans and guidelines before their consideration by the Board.

Box 1: Standing Committees Summary Terms of Reference

❑ **Finance Standing Committee**

Supervise development of financial plan
Advise the board on investment plan, fund raising and financial management.
Guide the development of grant making procedures in consultation with the program standing committee.
Review annual budget preparation and suggest improvements.
Review and update policy and guidelines (financial, procurement, personnel) as and when required.
Oversee the financial audit.

❑ **Program Standing Committee**

Provide guidance in developing a comprehensive program.
Based on the strategic documents, finalize the work plan and advise on implementation priorities.
Advise on short (2-3), medium (4-8) and long term (10-20 years) objectives of AF.
Review the program/work plan of Arannayk yearly.

❑ **Operation Standing Committee**

Advise on general operational guidelines for program implementation
Suggest the possible inputs required and the possible outputs including verifiable indicators.
Provide guidance to identify different stakeholders of tropical forest conservation and biodiversity.
Suggest stakeholders' selection methods; grant making procedures, capacity building and management system.
Define the field monitoring needs and the parameters to be considered for the program components, periodically monitor their development and report to the Board on the results

4.08 The Standing Committees met actively in the early days of the Foundation. Meetings slowed after 2005, and no committee has met since August 2007. The Finance Standing Committee rarely had more than two of its three members in attendance, while the other two Committees had only one fully attended session each. The Operations and Programs Standing Committees met in joint session more often than separately, begging the question of whether a merger could form a more effective body. It should be recognized that the small size of the Board makes it difficult to constitute working committees with a viable size and the ability to meet more frequently than the Board itself. Article 19 (l) allows the Board to appoint persons who may or may not be employees of the Foundation to its committees. Consideration should be given to bringing in outside expertise which could re-energize the Standing Committees at this critical juncture in the Foundation's life.

4.09 Board Effectiveness. The two Government Board members serve in an ex-officio capacity for their governments, and must resign when an individual succeeds them in their designated government positions. The US representative changed once, in late 2007. Four GOB representatives, who have always held the position of Joint Secretary of the Ministry of the Environment and Forests (MOEF), have served since 2003, with two of them remaining one year or less. Better continuity for the GOB Director, easier meeting scheduling and better-briefed Directors, would be possible if each Board member had one alternate who could participate in Board meetings at his/her request. Generally, alternates are not official Board members and do not vote or enter into decisions on behalf of the actual Director. There are, however various procedures that allow the alternate to place a position on the record for subsequent confirmation by the absent Director.

4.10 Non-governmental Board members are appointed to serve three year terms, with the possibility of one renewal for a second three-year term. The five current members were initially appointed on July 26, 2003, and all were renewed for a second term in July 2006. Thus, all five non-governmental Board members are scheduled to leave the Foundation in July 2009, with the prospect of a largely new Board and only minimal continuity.³ To soften the impact and achieve a smooth transition, it is imperative that the process of identifying new Board members begins immediately. According to the AoA, nongovernmental directors are appointed by the GOB after consultation with a wide range of local nongovernmental entities and with the consent of the USG Director. The GOB Director should inform the other Board members of the process that will be followed, ensuring that it is transparent and well-documented, in order to avoid being challenged by disappointed or disgruntled stakeholders. The appointees should attend at least two Board and Committee meetings before July 2009, to gain familiarity with Board work and its processes. To avoid repeating this situation, the AoA should be amended to introduce staggered terms for the nongovernmental Board members.

4.11 The Board is required by its Articles of Association to meet at least once every three months. It has done so except in 2006 and 2007, when the whole Board convened only three times each year. The Board also met once in 2007 without the requisite quorum of five members. Arranging Board or Standing Committee meetings has not always been easy, given competing obligations of the Board members. The AoA allow telephone and video conference meetings, and these options could usefully be expanded to include virtual meetings .Consideration should be given to expanding

³ Reassignment of the GOB Director was announced during the evaluation team's visit, with the implication that a sixth Director would also be relatively new at the time of the July 2009 Board change.

Article 24 of the AoA to include that option. The situations which justify virtual meetings would need to be defined by the Board, as well as the supporting procedures that ensure virtual meetings terminate in a clear Board decision.

4.12 The difficulty has been compounded by the absence of one Board member for more than a year. Given restrictions in its Articles, Arannayk has no recourse except to appeal to that individual's sense of moral obligation in hopes of obtaining a voluntary resignation. In this situation, the Board is hostage to Article 12 of the AoA (and Article III(4) of the bilateral Agreement) that state that directors may be removed only for malfeasance. There are several instances in which a board might wish to remove one of its members to ensure its effective operation: illness, prolonged absence, non-performance. Article 12 should be amended to include legitimate causes for removing a director.

4.13 Detailed minutes have been duly prepared for every Board meeting. Precise outcomes on key issues were not always easy to determine and closure was not always recorded. Examples include the final naming of a fiscal agent, the auditor's conclusion on tax liability, audits, and the amounts of projects or grants that receive a definitive approval by the Board (there are several approvals of the same project, making it difficult to determine when a financial commitment is actually made). Efforts by the current Executive Director have resulted in better recording of discussions and these are now supported by a succinct "Decisions at a Glance" that records the key meeting outcomes. With Board Chairs who serve for only one year (as few as four meetings), Arannayk Staff, in the role of Board Secretariat, should also ensure that each topic discussed is brought to closure and that the outcome is clearly recorded. New and updated policy and procedural decisions of the Board should be recorded in a log, and the log should be kept current.

4.14 The difficulty of recording with precision may be linked to the Board's practice of taking decisions consensually. In fact, Article 23 of the AoA states that "Resolution shall be decided by a vote of the Members or Directors as so required and in accordance with these Articles. The Board Members may adopt a resolution upon written unanimous consent of all the Directors/Members." Clarity of decision making might be improved if the Board was to vote and voted decisions recorded. The Board has not developed detailed procedures beyond the AoA, but should do so to clarify the practical modalities of implementing the Articles. For example, in what circumstances would written consent be used or unanimous decision be required. Clarification of Article 49 to amend the AoA is also needed, since the current formulation as "special resolution with the consent of both Government Members", does not distinguish between "consent" and "approval" which is required elsewhere in the AoA. Board procedures should be filed in the Operating Manual.

4.15 The General Body. The seven Board Members also form the General Body. While it is unusual to have two bodies with identical membership, this was done to make certain the Board could operate with unchallenged authority, especially in the critical early years of the Foundation. The General Body is required to (a) recommend policy guidance, (b) approve the annual budget and supplementary budgets, (c) approve the prior year's balance sheet and audited accounts and (d) approve the annual report.

4.16 The General Body has held the requisite annual meeting since 2005. The meetings served to nominate a new Board Chair, approve an annual report and note changes in the Government

Directors. The AoA empower the Board only to prepare and submit a budget, while the General Body must approve it. Admittedly, the seven Directors are members of both bodies, but the General Body minutes should still record the budget approval even if it is *pro forma* to meet the statutory requirement. More importantly, there is no record of either a Board or General Body approval of the Foundation's balance sheet or any audit after financial year 2003/2004. An explanation of the audit gaps and recommendation are provided in paragraph 4.47 below. The General Body should carry out all of its responsibilities in line with the AoA and clearly record its decisions in the meeting minutes.

4.17 Recommendations

High priority:

- *Begin the process to identify new Board members immediately. The GOB should indicate to the Board how it will proceed with consultations, and ensure that a transparent and well-documented process is followed.*
- *Allow new nominees to attend a few Board or Committee meetings before July 2009, to gain familiarity with Board work, processes and procedures.*
- *Amend the AoA to introduce staggered terms for the nongovernmental Board members.*
- *Amend Article 12 of the AoA to include legitimate causes other than malfeasance for removing a Director.*
- *Take decisions by vote, rather than consensus, as required by the AoA. Record all decisions clearly in Board minutes.*
- *Develop detailed Board procedures beyond the AoA, to clarify the practical modalities of their implementation.*
- *Ensure all responsibilities of the General Body are carried out in accordance with the AoA.*

In the interest of efficiency and effectiveness:

- *Add outside expertise to the Standing Committees to help with the tasks that need to be completed before July 2009.*
- *Consider merging the Program and Operation Standing Committees.*
- *Expand Article 24 to add virtual meetings to the existing options of phone and videoconference meetings. Define the conditions that justify holding virtual meetings and the supporting procedures that ensure meetings terminate in a clear Board decision.*
- *Allow each Board member to name one alternate who could participate in Board meetings at his/her request.*

- *Ensure that each topic discussed by the Board is brought to closure and clearly recorded in the Board minutes. Create a log of new and updated Board decisions on policy and procedure, and keep it current.*

Management and Administration

4.18 Overview. The Foundation is staffed by an Executive Director, a Senior Program Officer, a Finance Manager and several support personnel. Two additional junior positions were approved for a monitoring and a communication specialist, with the former currently filled under a consulting arrangement. All operating staff are highly qualified individuals, who impressed the evaluation team with the depth and breadth of their technical knowledge, their rapport with clients and their strong desire to manage Arannayk as a “best practice” institution.

4.19 The Foundation has had two Executive Directors since its creation in 2003. The first was credited with putting in place an appropriate policy and procedural framework, assuring the early strategic work that defined the initial programs and grant portfolio of pilot and research activities. The second Executive Director, in place since February 2007, has worked with his team to reinforce the existing framework, especially the grant making procedures, and strengthen the grant portfolio, by eliminating non-performers, assisting grantees to improve implementation and moving forward with larger and more complex co-management projects.

4.20 Grantmaking. As of June 30, 2008, Arannayk’s Board had approved 46 grants for a total of BDT 205.9 million (US\$ 3.0 million). One project comprising 26 grants was completed, three grants were closed, ten were under implementation and seven had not begun implementation. Of those, five were awaiting approval of the USG, GOB or both.

4.21 Arannayk has followed a competitive process to awards its grants. The process is codified in its Competitive Grantmaking Procedures, first issued in March 2006, and updated in 2008. Two different approaches have been used. For most grants Arannayk has followed a classical approach that has defined the issues to be addressed or conservation objectives, solicited costed project proposals and then selected the best proposal based largely on technical merit and the organization’s strengths. More recently, for more complex grants, Arannayk has provided the indicative project design, and used competitive selection, emphasizing the entity’s experience and proposed implementation approach, to choose an implementing entity.

4.22 The process now being followed is thorough and meets best practice standards for grant-making for the following reasons:

- The invitation of proposals is published in two to three newspapers for broad coverage.
- Deadlines are reasonable, averaging four weeks.
- There are clear eligibility criteria indicating who can apply.

- Potential grantees are referred to the Arannayk website from which they can obtain forms, very detailed and clear guidelines that walk them through the submission process.
- Proposals must provide for a baseline study and indicators; the 2008 cohort of grant solicitations introduced a simplified logframe as the basis for monitoring progress against objectives.
- All grantees are informed of the basis on which winning proposals will be selected, ensuring a level playing field and transparency.

4.23 Improved clarity in formats and guidance should result in higher quality proposals and more qualified implementing entities. Both proposals received and grant implementation have been troubled by weak grantees. In response, as an added assurance of grantee performance capacity, Arannayk staff will perform due diligence before awarding grants by visiting potential grantees' offices and field sites, as well as reviewing their last audit report.

4.24 Arannayk does not have a large in-house technical staff, and instead uses a panel of external experts to evaluate proposals. Based on the type of grant, a panel of three reviewers is drawn from a Board-approved roster, and proposed to the Board for endorsement. Each reviewer scores all proposals. This approach has worked relatively well, although there were instances when reviewers' views did not coalesce on non-responsive proposals or clear grant awards. The process could be made more efficient through a first triage by Arannayk Staff to eliminate non-responsive submissions. Arannayk's procedures also provide for a two part selection process, using a concept note to target the better proposals and eliminate those that are non-responsive or weak, but this was tried and deemed to add too much time to the process.

4.25 Grants are approved by the Board, a multi-step process whereby the Board considers the broad concept, often in conjunction with approval of a strategic program, approves the call for proposals and finally grant award. Arannayk has been very effective in moving to signature of a grant agreement once approval is obtained. Grantees also mentioned that "things moved quickly" after approval, with funds made available promptly.

4.26 Arannayk's approach for monitoring and oversight of approved grants is commendably "hands on" and drew positive comments from all of the grantees interviewed. Each grant is launched with a project implementation plan for the life of the grant-funded activities. In line with best practice, each grantee is required to submit a quarterly report of activity progress and use of funds for the duration of the project. Arannayk staff visit project sites quarterly to ground truth progress and help grantees resolve issues. All grantees are then invited to the Arannayk's Dhaka office to present their quarterly results and share experiences. The cycle ends with the grantee submitting an annual report and an operating plan for the next year. The quarterly meetings make use of collective knowledge to problem solve and have helped to build a support network among implementing NGOs, academic and research institutions.

4.27 An elaborate and thorough procedure has also been developed by Arannayk Foundation staff to generate and monitor payments to grantees by electronic means. This minimizes the scope for

errors while creating an efficient and checkable system of channeling funds to the grantees in various parts of Bangladesh. This is supplemented by verification in the field by Arannayk Foundation staff who are expected to ensure that the funds have actually been spent on approved programs and within approved parameters. This system to monitor grantee funding is an impressive achievement.

4.28 Five grantees were interviewed to determine what did and did not work well with Arannayk's grant making approach. Their comments, overwhelmingly positive, are summarized in Box 2. In interviews with FD representatives, they stated that Arannayk's clear comparative advantage is its experience working with communities and income generating activities.

Arannayk is viewed by the FD as a potentially valuable, but as yet untested partner in the move from "social forestry" to co-management of parks and reserved forests.

4.29 Arannayk also received praise for its rapid response to two unforeseen situations. In one instance, a BDT 1 million (US\$ 14,700) grant was made to the Bangladesh Forest Research Institute (BFRI) for an emergency information dissemination program to conserve damaged trees in Sidr affected areas. The second was a BDT 477,000 (US\$ 7,015) grant, approved as an amendment to an existing grant that seized a rare opportunity. Bamboo flowers every 25-40 years, attracting vermin who eat the fallen seeds and crops around them. The grant not only instituted vermin control, it taught communities how to collect bamboo seeds which they could then plant to expand their holdings. Arannayk management's agile responses not only created good will, but also furthered the Foundation's reputation for effectiveness. Many Conservation Funds and Foundations have an emergency Board procedure that allows them to respond rapidly and decisively to both crisis and opportunity. A streamlined procedure should be adopted for the Board to rapidly consider and approve grants that address urgent or emergency situations.

Box 2: Client views on Working with Arannayk

What works well?:

Easier to work with than [*our usual*] donor. .
Funds were released promptly, only one month after grant approval
Getting funds released is easier than with ministries.
Reporting is easy.
The Quarterly Report is straightforward and simple.
The technical proposal was easy. Arannayk responded promptly to our difficulty with the financial proposal.
We get good support from the financial person at Arannayk.
We appreciate field support and quarterly meetings (as opposed to donors who don't visit projects very often).
There are very useful quarterly meetings at Arannayk because feedback is immediate.
There are frequent visits and good e-mail exchange, which helps flexibility and problem solving.
The orientation meeting before the Homestead project was very useful.
The new Director approached us as a partner. We are not interested in being a tenderer.

What could be improved?

Arannayk's interventions have short-term focus while conservation must have a long-term vision.
Arannayk should work more with research and scientific institutions to backstop on capacity building, technical aspects and field monitoring.
Delays in approval impact business planning. A proposal was submitted in early 2007 [*referring to the Inani project*], and resources notionally allocated. Because of delays, the work plan had to be changed and staff whose CVs were in the proposal had to be reallocated to other work.

4.30 Additional Approval by the GOB and USG. Grants with a life of project cost exceeding US\$100,000 equivalent also require approval by the Bangladesh and US Governments, although for the latter, authority for approvals up to \$300,000 was recently granted to the US Ambassador. In the case of the proposed Conservation of Natural Forests at Inani project which has a total value of BDT 70.3 million (US\$ 1.02 million) and the Forest Department as one of its three grantees, the Arannayk Board gave its first approval to the proposal in June 2007. Approval of the Bangladesh Government was received _____. The USG approval took into consideration the grant size as well as the precedent being set by the first grant to a government entity. The bilateral Agreement Establishing the TFCF allows government entities to receive grants, but only on an “exceptional” basis. The USG approval was received only in August 2008, after more than two months of internal deliberations. Article 20 of the AoA that sets the Government approval threshold also states that “if either Government Director fails to disapprove an award or grant within 30 days of its presentation, such award or grant shall be deemed approved by such Government Director”. Arannayk has found it politically impossible to invoke this clause, even though both Governments also committed to it in Article IV(3) of the bilateral Agreement. Arannayk’s Financial Plan through 2014/2015 (paragraph 4.41) includes indicative grants that partner with the Forest Department and could exceed the approval threshold. Lengthy approvals might be avoided by obtaining the two Government’s *ex ante* agreements in principle through their review of the proposed Financial Plan, as well as their review of the proposed Strategic Plan (paragraphs 4.57 -4.59). Setting the limits for “exceptional” cases (no more than X% of any project; will not replace financing already provided by the GOB, will not finance salaries, etc) could also facilitate review. Resolving issues at any early stage could expedite review of the final grant proposal, avoiding delays in grant awards and project launch.

4.31 Recommendations

High priority:

- *Adopt a streamlined procedure for the Board to rapidly consider and approve grants that address urgent or emergency situations.*
- *Use the review of the Strategic and/or Financial Plans to obtain ex ante agreements in principle from the two Governments for grants exceeding the review threshold and other exceptional situations.*

Financial Management

4.32 Payments into the Tropical Forest Conservation Fund. All payments by the Bangladesh Central Bank into the Arannayk Foundation’s account have been made in accordance with the bilateral Agreement on Debt Reduction. Although payments were scheduled to begin on 30 September 2000, discussions of the Articles of Association took more than two years, culminating with creation of the Foundation in June 2003. Transfer of payments into the TFCF account was delayed further by discussions of the applicable dollar to taka exchange rate. The latter ended favorably for Arannayk which preserved the taka equivalent of about \$500,000 it would otherwise have lost as a result of the

decline of the taka against the US dollar. Subsequently, on October 11, 2004, the TFCF received the first payment of \$3,245,030, representing the sum of all installments due up to that date. Since then, all quarterly installments were received regularly. BDT 357,817,829 (US\$5,715,129) was paid in against installments due as of June 30, 2008. Annex V: Debt Service Payments is a summary of installments due and corresponding payments received.

4.33 Project and Grant Status. Sixteen projects comprising 46 grants with a total value of BDT 205.9 million (US\$ 3.0 million) were approved by the Arannayk Board between February 2006 and June 2008. Thirty grants of those approved are closed and nine are currently disbursing. Grant disbursements as of June 30, 2008 were BDT 21.2 million (US\$ 0.3 million). Unused funds from completed or cancelled grants total BDT 8.1 million (US\$ 0.12 million). The status of project and grant approvals is set out in Annex VI: Approved Grants.

4.34 Commitment of funds from the TFCF began slowly, as the Board moved prudently to put in place the policies and procedures and strategic framework for grant-making. The Board first met in August 2003, but grant-making began in late 2005 after the hiring of an Executive Director and two senior staff (completed late 2004), adoption of basic policies and procedures, naming of the three Standing Committees and a study to determine the initial strategic programs that guide grant-making (all in 2005). The first grants received final approval in February 2006, grant agreements were signed and funds were released promptly thereafter. All early grants, approved in 2006 and 2007, were in the range of BDT 3.5 -5 million (USD 50,000-73,000). In 2007, the first large grant in the amount of BDT 70 million (USD1.03 million)-was approved for the Conservation of the Natural Forests at Inani. In January 2008, management proposed, and the Board accepted, a strategic change to pursue larger size grants supporting community co-management of parks and reserved forest. This group of grants, ranging in size from BDT 11-31 million (US\$ 160,000-450,000) will build on the positive experience of USAID's Nishorgo Support Project. Once they are approved by the GOB and USG, commitments and disbursements will pick up significantly.

4.35 Disbursement of individual grants has generally been on target, with only one (CFSD Coastal Biodiversity) of the twelve currently disbursing grants experiencing a lag with respect to its planned implementation. It should be kept in mind that, not only are the grant amounts small, but also early grant-supported projects have implementation periods from four to eight years, resulting in small annual disbursements.

4.36 Three grants were terminated for poor-performance. BDT 1.7 million (US\$25,110) of a total approved amount of BDT 9.2 million (US\$135,310) was disbursed from two of the three grants, and BDT 7.5 million (US\$110,200) will be cancelled and returned to the pool of grant funds (see paragraph 4.48 below for audit results). Some allowance can be made for the fact that these projects were undertaken in the early days of the Foundation's grant-making, but lessons learned should be integrated into future operations. Monitoring by Arannayk has improved with the arrival of the new management team, and a practice of regular audits of all grants will be initiated in the 2008/2009 financial year.

4.37 Financial Position. Arannayk's financial statements have been reviewed and key financial figures from the start of operations in 2003 appear in Annex VI: Cash Flow for the Period 26 July 2003 to 30 June 2008. The summary of that annex appears in Table 1 below.

Table 1: Cash Flow 26 July 2003 to 30 June 2008

	<u>BDT millions</u>	<u>US\$ millions</u>
Total Inflow	436	6.41
of which		
Tropical Forest Fund ⁴	348	5.12
Income from Investment	88	1.3
Total Outflow	(55)	(0.81)
of which		
Core Costs	(30)	(0.44)
Program Costs	(25)	(0.37)

Income from investment of BDT 88 million (US\$ 1.3 million) exceeds total expenditure to date of BDT 55 million (US\$ 800,000), which means that all the operations of the Foundation to date have been funded solely from investment income. The principal of the TFCF has a net growth of about BDT 33 million (US\$ 0.49 million) through re-investment of unspent interest income.

4.38 Arannayk's approved budget has Core and Program Expenditure components. Core Expenditures are defined as the administrative costs of running the Arannayk Foundation, including staff salaries, consultants, operating overheads and depreciation. Program Expenditures are made up of grant disbursements plus the cost of studies and support to grantees. In July 2006, the Board set the objective of Core Expenditures not exceeding 25% of total costs, and has since approved annual budgets consistent with that principle. Understandably, newly created Conservation Trust Funds and Foundations have frontloaded operating costs that dominate their cost structure until grant making programs are fully operational. Many also set an easier target ratio of administrative costs to new grant approvals, which can lead to emphasis on quantity over quality. Either way, target ratios are rarely attainable before Year 3 of grant making when new foundations tend to reach "cruising speed".

4.39 In Arannayk's case, Year 3 of grant operations was 2007/2008, and the Core/Total Expenditure ratio for that year was 41%. The high ratio resulted because six of the grants approved by the Board between June 2007 and February 2008 exceeded the \$100,000 threshold that requires approval by the "Parties", i.e. the GOB and the USG. The five were submitted, but the Government approval process was not completed during the financial year, and nearly halfway through 2008/2009, five grants are still not approved. There is little Arannayk can do to reduce its Core Expenditures. Salaries and benefits represent more than half of Core Costs, but there are only three senior and two junior staff positions, just a critical mass. An expanded grant portfolio with robust disbursements is the key to achieving the 25% target. The ratio has fallen steadily over time, and the target could be reached in the next two years, but only if Board approved grant proposals are acted upon promptly by the two Governments.

⁴ The June 30, 2008 installment was received on July 7, and therefore booked in financial year 2008/2009.

4.40 Financial Plan. Table 2 summarizes Arannayk’s financial plan for the seven years 2008/2009 through 2014/2015. Arannayk’s projections for that period, prepared in constant 2008 BDT, assume that Core Expenditures will remain at today’s level (BDT 11 million), investments will return a reasonable 10% per annum, and the pipeline of larger size grants will result in an annual average increase in disbursements of 8.4%.. As a result, it is necessary to begin spending down the principal of the TFCF beginning in 2009/2010. By 2014/2015, BDT 243.6 million (about US\$ 4 million equivalent⁵) will have been drawn down from the TFCF principal. Even so, Arannayk estimates that the TFCF at the end of the period will still have a value of BDT 279.4 million (US\$ 4.1 million). At that point, only about \$340,000 will remain to be paid into the TFCF. Given the relatively rapid draw down of the TFCF, initiating fundraising becomes a high priority for the longer term survival of Arannayk.

Table 2: Summary Financial Plan 2008/2009 to 2014/2015

	<u>BDT millions</u>	<u>US\$ millions</u>
USES		
Total Cost	575.71	8.47
<i>Core Expenditures</i>	<i>77.00</i>	<i>1.13</i>
<i>Program Expenditures</i>	<i>498.71</i>	<i>7.34</i>
of which: Ongoing Projects	43.61	0.64
Identified Upcoming projects	172.79 (including Inani)	2.54
Future Programs (non-FD)	123.50	1.82
Future Programs (FD)	158.80	2.34
SOURCES		
Total	575.71	8.47
Investment Income	299.22	4.40
Retained Earnings	32.88	0.48
Tropical Forest Fund	243.61	3.58

4.41 Investment Practices. There is only a limited range of investment options available in Bangladesh as the stock market is quite volatile and there is almost no fixed-income bond market. Bangladesh Government Treasury bills are sold in large tickets only to authorized banks and financial institutions. At the same time, foreign exchange regulations do not allow investment in international markets. As a result, the Foundation’s Board of Directors has taken the decision to invest the Tropical Forest Conservation Fund in commercial bank deposits at the best rates available. The investment decision process is described below.

- Funds received from the Bangladesh Central Bank are routed in the first instance to Arannayk’s main account with Standard Chartered Bank (SCB), a multinational bank with an international credit rating.

⁵ Arannayk’s projections are based on constant 2008 BDT. As the taka has declined vis-à-vis the US dollar, using the current taka rate under-represents the dollar value of payments made in 2005 through 2006.

- The Arannayk Foundation’s finance staff make an assessment of the funds that will be required for operations and grant disbursement each quarter, as per the Financial Plan (budget) pre-approved by the Board. This amount is retained in a Short Term Deposit account with SCB, which pays about 5% interest per annum.
- The remaining funds are treated as available for longer term investment at much higher interest rates. Quotations are invited from a number of well reputed public limited commercial banks in Bangladesh, quoted in the stock market, which have no Government ownership. The banks offering the highest interest rates on Fixed Deposit Receipts (FDRs) but which also have high CAMEL, Credit Asset Management Equity Liability, ratings are shortlisted. CAMEL ratings are established by the Bangladesh Central Bank as a measure of the creditworthiness and other operational strengths of commercial banks operating in the country. These ratings are not generally available to the public, but Arannayk has been able to obtain them unofficially.
- The shortlisted banks, and their interest rate offers, are then referred to Arannayk’s Finance Standing Committee which makes the final selection and allocates the funds to each bank.
- The investment position is periodically reviewed by the Finance Committee and any changes needed to maximize investment income are made.

4.42 Article II (7) of the bilateral Agreement Establishing the TFCF sets a positive rate of return as an investment goal. Table 3 compares the local inflation rate, measured by the Consumer Price Index (CPI), with the actual returns attained during a comparable period. The table clearly shows that returns have been consistently higher than inflation, thus achieving a net positive rate of return.

Table 3: Actual Returns compared to Inflation

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
CPI	6.5%	7.2%	7.2%	10.1% (March 2008)
	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>
Actual Annual Return	9.45	11.42%	12.13%	12.13% (est.)

CPI Source : Asian Development Bank Statistical Database

4.43 Fiscal Agent. The bilateral Agreement Establishing the TFCF also foresees the appointment of a Fiscal Agent charged with investment of the Fund, disbursement from the Fund, and notifying Arannayk when the GOB payments are made. Arannayk has not appointed a Fiscal Agent, but carries out the indicated responsibilities as follows:

- The TFCF is held in Arannayk’s main account at the Standard Chartered Bank; the SCB notifies Arannayk when the GOB effects a payment.
- There are four accounts at the SCB: the main TFCF, a short-term deposit interest bearing account and two operating accounts for current and grant expenditures. Board decisions govern the transfers among accounts. Double signatures are required to effect disbursements from either the current or grant operating accounts. See Annex VII – Account Structure.
- Finally, Arannayk, through its Finance Standing Committee, chose to make its own investment decisions, and instructs the SCB to transfer funds to the banks offering the simple FDR instruments it uses.

4.44 Arannayk’s earnings to date have been good. However, the sole use of FDRs and heavy concentration in one bank could expose the Foundation’s funds to various risks, including those discussed below:

- Eighty percent (in value terms) of Arannayk’s FDRs are held by one bank. In line with sound investment practice, no more than 33% of the total funds available for investment should be placed in any single bank or financial institution. Also, given recent events affecting financial institutions worldwide, it should be noted that Government backed Deposit Insurance in Bangladesh banks is limited to individual deposits of BDT 100,000 only.
- Funds are currently being deposited with local commercial banks which, though well reputed in Bangladesh, are relatively small in terms of equity capital and overall balance sheet footing, and are not yet managed according to the highest international standards. The CAMEL ratings discussed earlier do not completely fulfill the function of the publicly available credit ratings which can help investors assess the standings of candidate banks. While the Bangladesh Bank has insisted, with growing success in recent years, that commercial Banks carrying out properly structured risk analysis, there remain issues relating to strict compliance and to governance. Publicly available credit ratings should be used to help evaluate the strength of a bank being considered for investment. Banks owned by the Government, which are relatively large in terms of balance sheet footing (if not in terms of capital), and which benefit from the implied Government guarantee, might also be considered as possible investment vehicles even if their interest rate offers are lower than those of the local commercial Banks.
- The members of the Finance Standing Committee, while distinguished individuals in their own fields, may neither have the necessary expertise in risk management to have a firm grip on all aspects of the task of managing an investment portfolio, nor enough time for this task. It should be noted that the members of the Finance Standing Committee are not remunerated for their work.

4.45 It is important that the Board, and the Finance Standing Committee have one member with expertise in finance matters and, ideally, relevant risk management expertise. Arannayk should consider engaging either a Fiscal Agent or the services of an investment adviser to review risks and, if necessary, suggest changes to current investment practice to address them and to guide investment decisions. Whatever guidance is sought, a written investment policy should be prepared that clearly spells out objectives and practice, including the risks that should be weighed when decisions are made. The investment policy will be a key chapter of the Operating Manual.

4.46 At the early stage of Arannayk's operation, with few investment options and just a few grants of small value, it would not have been cost-effective to pay fees for the limited services that a Fiscal Agent would have provided. At a point in the future, when other donor funds become available or if accounts are established offshore, it will be necessary to appoint a Fiscal Agent, both as a matter of prudence and to meet the terms of the Foundation's governing Agreements.

4.47 Audits. Article 8 of the AoA and the bilateral Agreement Establishing the TFCF require that an annual audit of the Foundation be prepared by the Board and presented to the General Body for approval each year. The only audit completed to date is related to Arannayk's 2003/2004 operations, for which the auditor issued a clean audit opinion. A second audit was performed for 2004/2005, but was not finalized owing to Arannayk's disagreement with the auditor's conclusion on tax liability. This is discussed in more detail in paragraphs 4.49 to 4.51 below. Whatever steps are taken to clarify Arannayk's tax status, it is of the utmost importance that the Foundation becomes current in its financial audits. Not only is this important for the USG as an assurance that Arannayk is on sound financial ground and has well-functioning controls, but it is also a critical element for prospective donors.

4.48 It is also standard practice for conservation funds or foundations to audit their grantees periodically, primarily to ascertain whether grant funds are used appropriately. Arannayk requested an audit of two projects with implementation issues, but had not, until recently, audited grantees. Discussions are underway with an accounting and audit firm which will initiate a program of annual audits of grantees in 2008/2009. The auditor's terms of reference are thorough, but could be strengthened by adding language that requires sufficient testing to be carried out in order to conclude that funds have been spent for intended purposes. The situations leading to audits and the audit outcomes are as follows:

- The implementing NGO of the ESCB project was found to be badly underperforming, even after it was given a chance to rectify matters. Accordingly, the Arannayk Board decided to terminate the project. The NGO was paid for the activities it had performed until the project was closed. Out of the grant amount of BDT 701,151 (USD 10,300) a total of BDT 451,451 (USD 6600) was disbursed. No anomalies were identified.
- For one of three grants for Pilot Level Community based Participatory Herbal Gardens, Arannayk's site visit determined that the implementing NGO had started working on a site that was owned by one of the Executive Members of the NGO. A few other irregularities were noted, following which a full audit was arranged. The auditors found financial and administrative irregularities, which led the Arannayk Board to immediately terminate the grant. The audit firm identified expenditures that

were considered to be justifiable, and only these amounts were settled. Out of the grant amount of BDT 5,000,000 (USD 73,500) a total amount of BDT 1,256,352 (US\$ 18,476) was disbursed.

4.49 Taxes. The Arannayk Foundation's practice is to treat the funds received from the GOB in accordance with the 2000 Debt Reduction Agreement as quasi-capital, and record them as liabilities of the Balance Sheet. However, the Foundation's auditor has proposed to classify these funds as "Income", in which case they will give rise to a substantial tax liability.

4.50 The bilateral Agreement Establishing the TFCF, states in Article II(1) that "Any monies deposited in the Fund, or grants made from the Fund, will be free from any taxation, levies, fees or other charges imposed by the Parties to the extent permissible by law." The position taken by the auditor, i.e. to treat grant funds as taxable income, does not appear to be consistent with the undertaking of the GOB. The Arannayk Foundation has not as yet accepted this Audit report for the year 2004/2005.

4.51 Arannayk should move quickly to submit a formal request for tax exemption with the National Board of Revenue, the country's taxation authority, and clear up this ambiguity once and for all. USAID Bangladesh has agreed to give its support to the request. The next Board Meeting of the Arannayk Foundation will address this issue on an urgent basis, especially since it is vital that the Arannayk Foundation's accounts for all the years to date be formally audited.

4.52 Financial and Procurement Procedures. The Financial Manual codifies Arannayk's procedures for budget establishment and monitoring, internal controls over expenditures, management of fixed assets, accounting policies and procedures, financial reporting and audits. The Procurement Manual guides the purchase of goods and services based on competition, transparency, value for money and evaluation by committee. Spot checks were made to see whether or not key provisions of the Manuals were actually being carried out. Results are as follows:

- Bank Statements were being reconciled, under dual control, at regular short intervals.
- In general dual control procedures were in effect, so that one employee's work was being checked by another employee.
- Leave registers were properly maintained.
- Investment registers were properly maintained.
- Dual signature is required for all payments by check or electronic means, with a Finance Committee member's signature required for amounts BDT 230,000 or over.
- Fixed Asset inventories were properly maintained.
- Procurement procedures, which require at least three quotations for procurement above BDT 25,000 (US\$368), were properly followed.

While this evaluation does not constitute an audit, based on review of the manual and spot checks, the financial procedures of the Arannayk Foundation are based on sound principles which are being correctly followed.

4.53 There are, nonetheless two opportunities for making financial operations more efficient:

- Consideration is being given to changing the accounting year from 1 Jul y- 30 June to a calendar year. This should be done to harmonize better with external reporting and monitoring requirements.
- At present, under the terms of the Arrannayk founding agreements, all disbursements to duly approved grantees above the equivalent of BDT 230,00 (US\$3,380) must be co-signed by a Finance Standing Committee member rather than processed by the Secretariat of the Arannayk Foundation. This ceiling should be raised to BDT 700,000 (US\$10,000) because the taka has declined by 13% since the original ceiling was set, and future grants are increasing in size, while implementation periods are being shortened. Management could be made accountable ex-post through quarterly monitoring of disbursements and the annual audit.

4.54 Recommendations

High priority:

- *One new Board member should have financial expertise and, if possible, knowledge of financial risk management.*
- *Engage the Fiscal Agent, or alternatively an investment adviser to review risks and, if necessary, suggest changes to current investment practice to address them and to guide investment decisions.*
- *Prepare a written investment policy that clearly spells out objectives and practice, including the risks that should be weighed when decisions are made .*
- *Act quickly, with support from USAID, to submit a formal request for tax exemption with the National Board of Revenue.*
- *Concurrently with the request for tax exemption, move forward with the audits for the three years 2005/2006 through 2007/2008.*
- *Strengthen the auditor's terms of reference for the grantee audits to require sufficient testing to be carried out in order to conclude that funds have been spent for intended purposes.*

In the interest of efficiency and effectiveness:

- *Integrate lessons learned from non-performing/cancelled grants into new operations.*
- *When other donor funds become available or if accounts are established offshore, appoint a Fiscal Agent, both as a matter of prudence and to meet the terms of the Foundation's governing Agreements*

- *Change the accounting year from 1 July- 30 June to a calendar year to harmonize better with external reporting and monitoring requirements.*
- *Raise the ceiling that requires double check signature by a member of the Finance Standing Committee from BDT 230,000 (US\$ 3,380) to BDT 700,000 (US\$10,300.)*

Strategic Directions and Outreach

4.55 Strategic Planning A three pronged strategic plan covering site selection, NGO training and public awareness was developed by Chemonics International Ltd in 2002 with funding from USAID. At that time, the site selection strategy identified two areas, Lawachara National Park and Satchuri, then a Reserved Forest, as having the highest potential for on-the-ground activities. This was a targeted strategy intended to launch Arannayk's first few years of operation. Carrying out the study at that point may have been premature, since Arannayk did not become operational until mid-2004, some two years later. Subsequently, the two sites identified by Chemonics became pilots for a co-management approach under the Forestry Department's Nishorgo Support Project, funded by USAID.

4.56 The Chemonics strategy was presented to the Arannayk Board in 2005, but was not formally adopted. Instead, new efforts were launched to develop short and medium-term program strategies in line with the eligible activities outlined in the bilateral Agreement Establishing the TFCF. In mid-2005, to obtain more up-to-date information, two individual consultants were hired to review the protected areas system and assess ongoing and completed projects in order to identify opportunities for Arannayk's intervention. Upon completion of the studies, Arannayk staff made a series of field visits, consulted with relevant organizations, individuals and GOB departments, then reviewed the program of activities of the FD, academic institutions and NGOs. Taking all into account, draft short and medium-term programs were prepared and presented in a meeting to a broad group of stakeholders whose observations were incorporated. In January 2006, after review by the Program Standing Committee the programs, including prospective projects, were submitted to the Board. New programs were added since by following the same process, which has taken about 6 months to complete. Currently the number of programs has reached ten, although one is for studies and another for emergency operations.

4.57 This approach has successfully provided clear direction for early grant-making activities and allowed the Foundation to build partnerships, to provide training and support to grantees for higher quality proposals and implementation, and to capture opportunities by providing small grants in situations requiring rapid response. Still, the collection of programs may have served well as short to medium term strategy, but leaves important strategic questions unanswered for the longer term.

- What criteria must be considered for the Arannayk to adopt a "program": geographic location?, threat?, ability to leverage other actions?, appropriate stakeholders?
- Which are the programs of highest priority?

- What are the objectives for non-grant activities such as influencing forestry policy or supporting research, managing knowledge (starting with the lessons learned from Arannayk’s own grants).
- How should funds be allocated to achieve the greatest impact?
- Under what conditions will pilot interventions receive funding?
- In what ways will the Foundation collaborate with the many forestry and conservation stakeholders, especially the Forest Department?
- What additional funds will be needed?
- What institutional and impact indicators should Arannayk monitor to evaluate its own operation over time?
- With what frequency will the strategy be reviewed to determine whether revision is needed?

4.58 To answer these and other questions, an overarching strategic plan is needed. The time horizon could be five years or seven to synchronize with current financial planning. Such a document is generally brief and directional, rather than prescriptive. It should be written in-house, but take into account stakeholder views.

4.59 With the change of Board members in July 2009, the drafting of a strategic plan at this point is timely, and as one Director indicated, becomes the Founding Board’s “legacy” to its successors. A strategic plan can also be a key element for fundraising, especially if it can justify creation of a long-term sustainable finance mechanism such as an endowment. An initial draft strategic plan should be prepared over the next few months, consulted appropriately and approved as a draft by the full Board. The final Strategic Plan should be approved for use only after review and approval by the incoming Board.

4.60 Fundraising. The TFCF has received installments due through June 30, 2008 in the amount of US\$5,715,129 million. A total of US\$ 2,675,939.40 million remains to be paid in through 2018. Table 4 below shows the schedule of all remaining payments.

Table 4: Installments to be paid in through September 30, 2018

Year	Installment Due
2008	133,191.55
2009	472,224.60
2010	423,791.31
2011	375,358.00
2012	326,924.72
2013	278,491.44
2014	230,058.15
2015	181,624.84
2016	133,191.56
2017	84,758.27
2018	36,324.96
Total	2,675,939.40

4.61 Arannayk’s Financial Plan through June 30, 2015 (paragraph 4.40) projects a TFCF balance in mid-2015 of about US\$ 4.1 million. At that point, only US\$ 340,000 remains to be paid in under the current Agreement. In the outer two years of the Foundation’s financial projections, the TFCF is sinking, ie . expenditures exceed income, at an average of US\$ 670,000 per year. Assuming that a steady state in the level of core and program expenditures, Arannayk’s operations would cease in 2021 and the TFCF would be exhausted soon thereafter.

4.62 The AoA Article 31 (b) allows the Foundation to obtain additional grants from the GOB and funding from third parties, provided that receipt of any foreign funds “is consistent with Bangladesh law” The Board is empowered by Article 19 (k) to acquire endowments or other funds from the GOB, foreign governments, international agencies, other public or private bodies or individuals. Fundraising has not begun as yet, mainly because the Board felt that the grant program needed a “track record” and a solid utilization rate of the TFCF funds to make the Foundation attractive to donors.

4.63 Putting substantial financing in place is a long process, especially if funds are sought from bilateral or multilateral donors. The need to initiate a dynamic fundraising campaign soon is a priority if Arannayk is to continue operations in the long-term.

a. This outcome of this evaluation should reassure the current Board that there is sufficient positive grant-making experience to begin to go forward. In drafting the recommended Strategic Plan, the Board should ensure that it and the accompanying Financial Plan adequately justify the need for additional funding. Board members and Arannayk staff both spoke of the need for an endowment to provide steady income and ensure the future of the institution, so the Strategic Plan should build that case. The first task of the new Board could be to initiate development of a fundraising strategy in line with the overall Strategic Plan. The importance of the task seems to warrant creation of a dedicated Board Committee for that purpose. The Executive Director should be delegated a key role, both for continuity and because, in general, it is the Executive Director who takes the lead in seeking out and negotiating funding. The Foundation may also follow the lead of

other institutions that have engaged the services of a professional to help with design and launch of their fundraising strategy.

4.65 Local sources of funding should not be ignored. Given the scarcity of official and private donor funding, many conservation funds and foundations seek a portion of their financing from recurrent sources of in-country funding. Among these are payment for ecosystem services, business contribution and environmental compensation offsets, taxes and fees.

4.66 Communication. As Arannayk moves forward with its various strategies, it will need to fill the currently vacant position for a communications officer. Obviously, the primary task of this person will be to craft the strategy for communicating the very good story that Arannayk has to tell. Participation in the forthcoming strategy discussions would allow this person to gain an understanding of the institution's mission, its stakeholders and the many positive outcomes of its work. This would require timely hiring.

4.67 Arannayk submits an annual summary of its operations to the US Congress to fulfill a statutory requirement. It has not, however, prepared a formal Annual Report. An Annual Report presenting the Foundation's organic structures and operating modalities, strategic goals and approach, grant-making statistics, initiatives and successful endeavors and financial statements can provoke thoughtful internal discussions, and is a useful tool for outreach and fundraising. The evaluation team was informed that the idea was put forward to the Board and that the first report will be prepared for 2008/2009.

4.68 Arannayk.org will be a key tool in communicating with potential supporters, clients and the broad biodiversity community. The website is currently used very effectively to support grant-making operations, but its potential has not been fully realized. The communications officer should also have web development experience and the web site should be a flagship piece of the communications strategy.

4.69 Recommendations

High priority:

- *Prepare an overarching Strategic Plan over the next few months, consulted appropriately and approved as a draft by the full Board. The final Strategic Plan should be approved for use only after review and approval by the incoming Board.*
- *Support the Strategic Plan with a Financial Plan, and ensure that the two adequately justify the need for additional financing.*
- *The new Board should develop a fundraising strategy in line with the overall Strategic Plan.*
- *Create a Standing Committee dedicated to fundraising.*
- *Empower the Executive Director by delegating fundraising responsibilities to him.*

- *Fill the vacant position for a communications officer and integrate him/her into the various strategy discussions.*
- *Prepare a communications strategy to market Arannayk's image, attract new partners and support fundraising efforts within and outside of Bangladesh.*

In the interest of efficiency and effectiveness:

- *Consider engaging the services of a professional to help design the fundraising strategy and assist with its launch*
- *Exploit the public relations potential of arrannayk.org and make it the flagship of the communications strategy.*

Conservation Impact

4.70 Perhaps the greatest challenge for conservation funds or foundations is to demonstrate the impact that they have had on conserving biodiversity. This is particularly true for grants funds like Arannayk which support different types of activities – community forestry, research, regeneration of threatened species– and where the scale of their interventions is much smaller than the scale of the threat. Arannayk's grants have a four to eight year horizon, and only a few have reached the mid-point of their implementation. Many early grants are pilots, and would need to be scaled up considerably for their results to have meaning. It is therefore impossible at this point to draw a conclusion on the impact that Arannayk has had on biodiversity conservation. Arannayk has, however, adopted practices that should enable it to demonstrate conservation impact in the future.

4.71 Monitoring and Evaluating for Impact. Grantees are required in their proposals to state goals and indicators for biodiversity conservation. They also commit to a baseline survey at project start against which they should be able to measure progress. Quarterly and annual reports are submitted for each year of operation, providing opportunities for grantees to report several times throughout the implementation period. Arannayk is to be commended for putting these practices in place from the start, since monitoring of the biodiversity impact of grants is known to be the weakest area of performance for conservation funds in general. There are nonetheless several areas of practice on the ground that could be strengthened. The observed weaknesses come as no surprise since Arannayk's grantees are largely social, and not conservation NGOs, and have been thrust into an area of recognized complexity.

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proposals do not identify or prioritize the “threats” to the project area, e.g. human encroachment, unsustainable harvest of forest products, illicit activities—that will be addressed through the project. Monitoring should focus on the indicators that will track changes in the baseline situation, and hopefully a reduction of the threat through the project's intervention. Clear instructions and training for implementing entities could address this omission.

- The quality of baseline data varies considerably among the four survey reports that were reviewed. Baseline reports tend to identify, but not necessarily quantify, important information such as the presence of indigenous species. This, of course, is not true for grants made to scientific or academic organizations, which apply the expected rigor. Grantees should be provided expert assistance for these critical surveys and the identification of appropriate indicators, since this is widely recognized as one of the biggest challenges facing proponents of biodiversity conservation projects.
- Monitoring against objectives is not always informative because the project objectives themselves are not clear or are too ambitious. Arannayk is addressing this by changing the way in which grantees report on progress. Grants since 2007 now use a logframe that requires approaches, methodologies and activities to be defined for each objective, adding to clarity.
- There is no repository for the data that is being gathered, in part because it doesn't always meet standards of scientific rigor. If previously suggest actions to improve the data are adopted, Arannayk should consider options for collection, storage and analysis of data produced by its grant funded activities.

4.72 Ensuring sustainability of Alternative Livelihood Schemes. Many pilot activities provide only direct support to communities to introduce income generating activities, which can lead to limited results and few beneficiaries when funds are exhausted. Arannayk has required its implementing entities to establish bank accounts and revolving funds for community groups. These can operate like micro-finance mechanisms to sustain and expand the development of alternative livelihood activities, albeit on a relatively small scale. Arannayk's Strategic Plan should consider what role the Foundation can play to support scaling up of successful pilots. Many conservation funds take the role of deal broker to help NGOs market successes.

4.73 Other areas in which Arannayk is affecting conservation in a positive way:

- The “goodwill” value of small grants that improve the lives of communities should not be underestimated. In recognition of the benefits received from income generating activities, communities have formed groups for protection and conservation of adjacent forests.
- Arannayk's NGO grantees have been local NGOs with moderate to high levels of field experience working with CBOs and communities. Most of those NGOs did not have previous experience implementing tropical forest conservation or biodiversity related projects. By working with Arannayk, they are gaining new skills and knowledge that can be used to introduce conservation into their other development activities with communities. More training like the orientation sessions they have organized on forest biodiversity conservation and propagation, nursery and mother tree management should be sponsored, targeting actions that NGOs can make part of their way of doing business.

- Several Arranayk-supported projects are clustered in the Chittagong Division. Project proponents include NGOs, academic and research organizations. Quarterly meetings and Arranayk staff's encouragement have helped to form a network by that exchanges advice and support.
- Finally, Arannayk's interventions correlate strongly with the Action Plan to which the Government of Bangladesh has committed for its National Biodiversity Strategy. A comparison appears in Box 3.

4.74 Recommendations

High priority:

- *Ensure proposals identify threats, baseline studies cover them and indicators are identified to monitor progress against the baseline.*
- *Provide training and expert assistance to project implementing entities to help with baseline studies and identification of biodiversity conservation indicators.*

In the interest of efficiency and effectiveness:

- *Consider options for collection, storage and analysis of data produced by grant funded activities.*

BOX 3 Comparison of Arannayk Activities and the National Biodiversity Strategy and Action Plan

National Biodiversity Strategy Action Plan 2006	Arannayk Activities
Recognize the value and importance of biodiversity for the Bangladesh people and document properly its components, distribution and value	Grants finance promotion of the importance of biodiversity conservation to participating communities Grants requires collection of baseline data of flora to develop village based inventories
Conserve ecosystems, species and genetic pool of the country to ensure that the present and future wellbeing of the country and its people are secure	Supports regeneration and reintroduction programs for threatened and extinct species such as nursery development and community managed herbal gardening
Restore ecosystems and rehabilitate endangered species	Supports research projects, homestead gardens and nurseries to rehabilitate rare, threatened and endangered indigenous species Facilitate afforestation and reforestation programme
Adopt national measures and standards to deal with invasive alien species and genetically modified organisms	Must be adopted by a national level authority
Promote equitable sharing of biodiversity conservation costs and benefits among different sectors of the society	Provides grant funding to CBOs which would otherwise not have the means, to reduce threats and conserve biodiversity resources of national value
Contribute to raising awareness and building capacity of biodiversity conservation among the different sectors of the society	Grants supports awareness raising activities and training, to build capacity of NGOs and CBO to conserve biodiversity
Promote use of traditional knowledge for the conservation, use and protection of the local communities intellectual property rights	Grants to establish herbal gardens support traditional knowledge of the indigenous people and their local healers.
Establish institutions for intersectoral implementing mechanism for the Bangladesh National Biodiversity Strategy and Action Plan	Must be executed by a national level authority
Enhance Protected Area management, recognizing the benefits of collaboration with local communities in their management (co-management)	A first grant is approved to support co-management of the Inani Protected Area.
Ensure wise use of wetland resources	Grant will support management of the Hizol Koroch wetland forest
Establish participatory mechanisms to receive and utilize the inputs from private sector, civil society, academia and local communities about the different processes leading to biodiversity conservation, use and sharing of benefits	In Chittagong Division created and supports a network of NGOs, CBOs, universities and a research institute that provide advice and services to assist conservation efforts.
Review and develop biodiversity related legislation and establish a specific branch in the judiciary to deal with biodiversity and environmental issues	Must be executed by a national level authority
Establish an open and transparent monitoring and reporting system status and trends of implementing the principles of CBD	Must be executed by a national level authority
Develop a financial strategy that is innovative and sustainable	Developed revolving fund for sustainable management
Address issues of synergies with other Multilateral Environmental Agreements and processes that deal with climate change, disaster management, livelihoods, food security and sustainable development	Must be executed by a national level authority
Integrate biodiversity conservation into the national development making planning and processes	Must be executed by a national level authority

