



APPRAISAL REPORT

CAO Appraisal for Audit of IFC

CAO Compliance

C-I-R9-Y10-F126

June 18, 2010

**Agrokasa
Peru**

**Case of
IFC's involvement with Agrokasa/ Corporacion Drokasa**

Summary

IFC has done three investments with Agrokasa and Corporacion Drokasa, Agrokasa's parent company. In addition, in 2009, IFC considered a fourth investment. This fourth investment was appraised by IFC, but suspended prior to Board consideration and subsequently cancelled. In 2009, six complaints were filed by various stakeholder groups to the CAO. The complaints raised concerns about the impacts of Agrokasa's operations on the Ica aquifer and the project's compliance with IFC's standards and requirements. Since IFC never went ahead with the Agrokasa III project, the issues addressed are, in the context of the Agrokasa III project, limited to IFC's appraisal leading up to the point of the cancelling of the loan request. However, since IFC has multiple investments with the client, the due diligence, monitoring and follow-up of the earlier investments related to the Ica valley are included in order to address and understand how IFC assessed the performance of its earlier investment when appraising the potential fourth investment. CAO finds it unclear whether IFC policy provisions have been properly applied and whether IFC policy provisions have provided an adequate level of protection. CAO finds that a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future IFC projects. Consistent with CAO Operational Guidelines, the CAO will develop a Terms of Reference and conduct an audit of IFC on IFC's appraisal and monitoring of its investments in Agrokasa and Corporacion Drokasa. The audit's focus is IFC's appraisal and monitoring, and whether or not IFC complied with its own policy provisions. CAO does not audit IFC's client, consequently, CAO will not pose any judgment on the performance of IFC's client.

Office of the Compliance Advisor/Ombudsman (CAO)
for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group



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About the CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the president of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit www.cao-ombudsman.org

1. Overview of the CAO Compliance Appraisal process

When the CAO receives a complaint about an IFC or MIGA project, the complaint is first referred to the CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If the CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case will be transferred to the compliance arm of CAO, CAO Compliance, to appraise the concerns raised in the complaint for a compliance audit of IFC or MIGA. Alternatively, a compliance audit can be initiated by request from the President of the World Bank Group, the senior management of IFC or MIGA, or at the discretion of the CAO Vice President.

A CAO Compliance appraisal is a preliminary investigation to determine whether the CAO should proceed to a compliance audit of IFC or MIGA. Through CAO Compliance appraisals, the CAO ensures that compliance audits of IFC or MIGA are initiated only for those cases with substantial concerns regarding social or environmental outcomes.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of compliance auditing is on IFC and MIGA, but the role of the sponsor may also be considered.

A compliance audit appraisal, and any audit that ensues, must remain within the scope of the original complaint or request. It cannot go beyond the confines of the complaint or request to address other issues. In such cases, the complainant or requestor should consider a new complaint or request.

The CAO compliance appraisal will consider how IFC/MIGA assured itself/themselves of compliance with national law, reflecting international legal commitments, along with other audit criteria. The CAO has no authority with respect to judicial processes. The CAO is not an appeals court or a legal enforcement mechanism, nor is the CAO a substitute for international court systems or court systems in host countries.

The appraisal criteria are set forth in CAO's Operational Guidelines. The criteria are framed as a series of questions to test the value of undertaking a compliance audit of IFC or MIGA. The criteria are as follows:

- Is there evidence (or perceived risk) of adverse social and environmental outcomes that indicates that policy provisions (or other audit criteria) may not have been adhered to or properly applied?
- Is there evidence of risk of significant adverse social and environmental outcomes that indicates that policy provisions, whether or not complied with, have failed to provide an adequate level of protection?
- Is there evidence (or perceived risk) of significant adverse social and environmental outcomes where policy provisions, standards (or other audit criteria), were not thought to be applicable but perhaps should have been applied?



- Is there evidence that the application of some aspect of a policy, standard, guideline or procedure resulted in adverse social and environmental outcomes?
- Can the cause of adverse social and environmental outcomes not be readily identified and corrected through the intervention of the project team without a detailed investigation of the underlying causes or circumstances?
- Could a compliance audit yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

During appraisal, CAO Compliance holds discussions with the IFC or MIGA project team and other relevant parties to understand the validity of the concerns and to explore whether an audit would be warranted.

After a compliance appraisal has been completed, the CAO can choose only one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit as a result of the compliance appraisal, the CAO will draw up a Terms of Reference for the audit in accordance with CAO's Operational Guidelines.

2. Background and concerns that led to the Appraisal

1. IFC has done three investments with Agrokasa and Corporacion Drokasa, Agrokasa's parent company. IFC's involvement started in 1999 with Agrokasa (IFC # 9528), followed by Drokasa PCG (IFC # 23010) in 2004, and Agrokasa Expansion (IFC # 24873) in 2006. In addition, in 2009, IFC considered a fourth investment, the Agrokasa III (IFC # 26821). This fourth investment was appraised by IFC, but suspended prior to Board consideration and subsequently cancelled.

2. The scope of the first investment (# 9528) included the expansion of the cultivated area of an existing farm at Santa Rita and the development of a new farm at La Catalina (from 195 ha to 1,391 ha), situated 300 km south of Lima in the Ica Valley. The first disbursement was on January 14, 2000 and the project was closed on June 22, 2005. This was a category B project following the 1998 IFC Safeguard Policies and WBG's EHS Guidelines. The second investment (IFC # 23010) was a Partial Credit Guarantee for bond issuance by Corporacion Drokasa and its subsidiaries, including Agrokasa. It was approved September 30, 2004 and was closed in January 2008. This was a category B project. The third investment, Agrokasa Expansion (# 24873) included the acquisition of an existing, failed farm at Las Mercedes, located 200 km north of Lima, in Barranca. This was a category B project following the 1998 IFC Safeguard Policies and WBG's EHS Guidelines. This project is currently scheduled to close in May 2013.

3. The proposed fourth investment, the Agrokasa III project, comprised of a loan to support the Company's 2008-10 investment program and restructuring of its balance sheet from short- to long-term obligations. The investment program included implementation of new areas in the northern farm in Barranca and stated hydraulic improvements in the Company's farms in Ica. The stated hydraulic improvements included, according to IFC, measures to reduce stress on the Ica aquifer and more specifically involved the transfer of water from the Santa Rita site to La Catalina farm, located on one of the most distressed portions of the Ica aquifer. The loan request was cancelled in September 2009.

4. Between June 2 and July 24, 2009, six complaints were filed by various stakeholder groups – two of these were signed by local water users' associations, three requested confidentiality and one complaint was later withdrawn by the NGO that submitted it¹. The complaints raised concerns about the impacts of Agrokasa's operations on the Ica aquifer and the project's compliance with IFC's standards and requirements.

5. In March 2010, the CAO Ombudsman transferred non-negotiable issues related to the Sponsor's compliance with specific IFC requirements to CAO Compliance for appraisal.

¹ Ombudsman case synopsis on www.cao-ombudsman.org

Actions by CAO	
2009	
June-July	Six complaints from various stakeholder groups are lodged with the CAO.
2010	
March 8	CAO Compliance receives issues related to compliance with IFC standards for appraisal after the CAO Ombudsman assessment identifies them as non-negotiable. CAO Ombudsman will continue to have a limited engagement on the ground.
April	CAO Ombudsman's work is put on hold after one of CAO's staff is wounded by a gunshot in the Ica valley.
June 18	CAO Compliance discloses Compliance Appraisal Report

3. Scope of the Appraisal for an Audit of IFC

6. The scope of the CAO compliance appraisal includes the specific issues listed below, which were raised by the complainants. (The issues listed here do not necessarily reflect CAO Compliance's position, but are statements made by the complainants.)

- a) Violation of Performance Standard 6: The complainants believe that the Sponsor's past, current and future uses of water and land are unsustainable and do not comply with IFC's Performance Standard 6 on Sustainable Natural Resource Management. The complainants believe that, if approved, the proposed project would have exacerbated the unsustainable use of land and water by the Sponsor. The complainants state that the adverse impacts on the ground include:
- Serious depletion of the valley's aquifer
 - Extension of water scarcity to new areas not previously affected
 - Restricted access to water for community members, small-scale farmers and other agro-producers
 - Drying up of wells
 - Deteriorating quality of water due to salinization
 - Economic and social displacement
 - Social conflict due to competition over diminishing water resources.

The complainants highlight the fact that no current and comprehensive baseline study of the aquifer and the hydrology of the valley is in existence. Without such study, the complainants believe it is not possible to determine the sustainability of any water related development in the region.

- b) Violation of Performance Standard 5: The complainants state that given the adverse impacts listed above the Sponsor should comply with Performance Standard 5, Article 20 of on Economic Displacement.

- c) Violation of Performance Standard 4: The complainants state that project plans by the Sponsor to drill four Ranney-type wells and to transfer water from Santa Rita to La Catalina are in violation of Performance Standard 4, specifically provisions to “avoid or minimize adverse impacts due to project activities on soil, water and other natural resources in use by the affected communities” and to protect the quality of soil and water.
 - d) Violations of applicable national law: The complainants state that the location, type and concentration of several of Agrokasa’s wells are not compliant with water laws governing the region, and that some wells lack the required permits for legal operation.
 - e) Violation of IFC’s Disclosure Policy: The complainants believe that relevant project information has not been provided in a timely fashion or has been widely distributed at the local level, in violation of IFC’s Disclosure Policy. The complainants further state that, despite statements to this effect, certain documents, and specifically the Environmental Impact Assessment and Environmental Action Plan, have not been made available to the local communities.
 - f) Violation of Sustainability Policy: The complainants state that the above violations have the inherent consequence that IFC violates its own sustainability policy.
7. IFC’s earlier investments in Agrokasa and Drokasa fall under to 1998 Safeguard Policies, whereas the last project, Agrokasa III, that never went ahead, was appraised under the 2006 Performance Standards.
 8. Since IFC never went ahead with the Agrokasa III project, the issues addressed in the appraisal will, in the context of the Agrokasa III project, be limited to IFC’s due diligence leading up the point of the cancelling of the loan request.
 9. However, since IFC has multiple investments with the client involved in developing the Ica valley, the due diligence, monitoring and follow-up of the earlier investments related to the Ica valley are included in order to address and understand how IFC assessed the client’s capacity, how the earlier investments were appraised, and how they performed against the at that time applicable policy requirements.

4. CAO Findings

The appraisal finds the following:

10. In its appraisal of the potential fourth investment, IFC identified Performance Standards 1, 2, 3, 4, 5, 6 and 8 as applicable. IFC appraised the potential investment against these standards.
11. In its appraisal of the first three investments, IFC's Operational Policy 4.01 on the requirement of an environmental assessment was applicable, among others.
12. CAO finds that IFC never assessed an environmental impact study of the sustainable use of water resources that was compliant with IFC's requirements, IFC however intended to request such a study to be finalized after board approval.
13. In regard to the appraisal question whether there is evidence (or perceived risk) of adverse social and environmental outcomes which indicates that policy provisions (or other audit criteria) may not have been adhered to or properly applied, CAO finds that the issue regarding the overall stress on the aquifer is not disputed by IFC. It is however unclear to the CAO whether policy provisions have been properly applied.
14. In regard to the appraisal question whether there is evidence of risk of significant adverse social and environmental outcomes which indicates that policy provisions, whether or not complied with, have failed to provide an adequate level of protection, CAO finds that the issue regarding the overall stress on the aquifer is not disputed by IFC. It is however unclear to the CAO whether policy provisions have provided an adequate level of protection.
15. In regard to the appraisal question whether there is evidence (or perceived risk) of significant adverse social and environmental outcomes where policy provisions, standards (or other audit criteria), were not thought to be applicable but perhaps should have been applied, CAO finds that the issue regarding the overall stress on the aquifer is not disputed by IFC. It is however unclear to the CAO whether policy provisions have been properly applied.
16. In regard to the appraisal question whether there is evidence that the application of some aspect of a policy, standard, guideline or procedure resulted in adverse social and environmental outcomes, CAO finds no such evidence.
17. In regard to the appraisal question whether the cause of adverse social and environmental outcomes cannot be readily identified and corrected through the intervention of the project



team without a detailed investigation of the underlying causes or circumstances, CAO finds the question not applicable under the current circumstances.

18. In regard to the appraisal question whether a compliance audit could yield information or findings that might better inform the application of policies (or other audit criteria) to future projects, CAO finds that this might be the case.

5. The CAO Decision

19. The CAO concludes that this case merits an audit of IFC. Consistent with CAO Operational Guidelines, the CAO will develop a Terms of Reference and conduct an audit of IFC on IFC's appraisal and monitoring of its investments in Agrokasa and Corporacion Drokasa.
20. CAO audits IFC, and how IFC assured itself of the environmental and social performance of its investments. This audit will focus on IFC's appraisal and monitoring, and whether or not IFC complied with its own policy provisions. CAO does not audit IFC's client, consequently, CAO will not pose any judgment on the performance of IFC's client.