



**CAO Audit of IFC's Environmental and Social Categorization of the  
Amaggi Expansion Project**

**Final Report**

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**Office of the Compliance Advisor/Ombudsman  
International Finance Corporation/  
Multilateral Investment Guarantee Agency**

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## Acronyms

APP	Areas of Permanent Preservation
CAO	Compliance Advisor/Ombudsman
CCF	Corporate Citizenship Facility
CIC	Corporate Investment Committee
CPR	Cedula de Produtor Rural
EA	Environmental Assessment
ERS	Environmental Review Summary
ESMS	Environmental and Social Management System
ESRP	Environmental and Social Review Procedure
FBOMS	Fórum Brasileiro de ONGs e Movimentos Sociais para Meio Ambiente
IFC	International Finance Corporation
INPA	Instituto Nacional de Pesquisas da Amazônia
INPE	Instituto Nacional de Pesquisas Espaciais
LAU	Licença Ambiental Unica
MIGA	Multilateral Investment Guarantee Agency
NGO	Non-governmental Organization
PCDP	Public Consultation and Disclosure Plan

## Executive Summary

This report was prepared in response to a November 2004 request from the Executive Vice President (EVP)<sup>1</sup> of the International Finance Corporation (IFC), for the Compliance Advisor/Ombudsman (CAO) to audit IFC's environmental categorization of the Amaggi Expansion Project in Brazil

The Amaggi Expansion Project was sponsored by a Brazilian company, Grupo André Maggi Participações Limitada. The company has agricultural, industrial and export/transport operations in the Brazilian states of Mato Grosso, Para, Rondonia and Amazonas, and is involved in the production, processing, trading and export of a number of agricultural commodities. Most of its operations are soy-related within Mato Grosso, although it also has interests in corn and cotton. In September 2004, the IFC Board approved a loan of US\$30 million for IFC's own account to finance the expansion of Amaggi's soy operations in Mato Grosso.

Criticism of IFC's categorization of the project primarily rests on the indirect impacts of Amaggi's third-party soybean suppliers on deforestation in Mato Grosso.

The two key questions the audit addressed were:

- Did IFC follow its own procedures on categorization?
- Was IFC's categorization of the project as a Category B justified?

To find answers to these questions, the CAO preformed a desk review of IFC project and other relevant documents, held discussions with IFC's Amaggi project team, and made field visits to Brazil.

## Findings

CAO recognizes: (i) a continuum rather than a strict boundary between A and B projects inherent in IFC's ***Procedure for Environmental and Social Review of Projects***; and (ii) that the procedures allow for professional discretion and flexibility in the assignment of a project to a Category based on adequate assurances that expected impacts can be mitigated.

On the question of **whether IFC followed its own procedures on categorization**, CAO finds that IFC did follow its categorization procedures. CAO also finds that IFC:

- Has procedures for categorization that are loosely defined and rely heavily on professional discretion;
- Has an informal "established practice" on categorization to address the supply chain impacts of agribusiness projects that may not be fully supportive of a robust appraisal process; and
- Does not provide for disclosure around categorization decisions that would enable interested or affected parties to make an informed judgment about the adequacy of IFC's categorization decisions.

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<sup>1</sup> The request was made by Peter Woicke during his tenure as IFC Executive Vice President, which ended in February 2005.

On the related question of **whether IFC's categorization of the project as Category B was justified**, CAO finds that IFC:

- Required that Amaggi implement an ESMS in order to mitigate potential adverse social and environmental impacts;
- Assured itself that Amaggi's own-managed operations were in compliance with environmental and social requirements;
- Assured itself that the potential impacts of construction of soy storage silos could be adequately addressed through an EA; and
- Required Amaggi to provide a reasonable opportunity for meaningful discussion of civil society.

CAO also finds that IFC:

- Did not adequately assure itself of whether or not the ESMS would afford an appropriate level of environmental and social protection, and ensure compliance with IFC's environmental and social requirements during project appraisal;
- Did not undertake a sufficiently rigorous assessment of the status of implementation of Amaggi's ESMS as part of its appraisal of the second loan; and
- Did not clearly define its expectations of Amaggi as regards issues to be addressed by the assessment of the proposed silo locations and the required level of detail.

CAO finds that the Category B rating can not be fully justified unless these conditions are met.

### **Recommendation**

CAO recommends that IFC prepares and publicly discloses a note on the actions it intends to take in response to the audit findings.

# 1. Introduction

## 1.1 Background

This report was prepared in response to a November 2004 request from the EVP<sup>2</sup> of the IFC, for the CAO to audit IFC's environmental categorization<sup>3</sup> of the Amaggi Expansion Project in Brazil (IFC Investment number 22561). Annex 1 is a copy of the EVP's request. The CAO is the independent recourse mechanism for the IFC and Multilateral Investment Guarantee Agency (MIGA), and reports directly to the President of the World Bank Group. In accordance with its Operational Guidelines<sup>4</sup>, the CAO screened the audit request against its appraisal criteria and accepted the audit request in mid-November 2004.

Categorization occurs at an early stage of IFC's project review process, called "project screening". The objective is to decide on the nature and extent of the environmental assessment (EA) needed for the project. The category assigned depends on "*the type, location, sensitivity and scale of the project and the nature and magnitude of its potential environmental impacts*". There are three project categories, C, B and A, with increased degrees of environmental scrutiny associated with each. Projects designated as Category C are likely to have minimal or no adverse environmental impacts. A project is assigned to Category B if "*if its potential adverse environmental impacts on human populations or environmentally important areas. . . are less adverse than those of Category A projects*". A proposed project is classified as Category A "*if it is likely to have significant adverse environmental impacts that are sensitive, diverse or unprecedented*". A full environmental assessment is required to be undertaken by the sponsor of a Category A project. (The system is discussed in more detail in section 2.1).

The Amaggi Expansion Project was sponsored by a Brazilian company, Grupo André Maggi Participações Limitada (hereafter referred to as Amaggi). The company has agricultural, industrial and export/transport operations in the Brazilian states of Mato Grosso, Para, Rondonia and Amazonas, and is involved in the production, processing, trading and export of a number of agricultural commodities. Most of its operations are soy-related within Mato Grosso, although it also has interests in corn and cotton. In September 2004, the IFC Board approved a loan of US\$30 million for IFC's own account to finance the expansion of Amaggi's soy operations in Mato Grosso. At the time the loan was approved, Amaggi was an existing client of IFC (having received a prior loan of US\$30 million in September 2002. The second loan was to: (i) provide working capital to support pre-financing of Amaggi's third party soybean suppliers and (ii) finance construction of three new soybean storage silos with a combined capacity of 250,000 tons, and purchase equipment.

The proposed project was assigned a Category B rating by IFC, as had the earlier Amaggi project. The view of IFC staff is that the B rating was appropriate for the expanded project because IFC's investment would not be funding any activity directly associated with expansion of soybean production and because IFC had made considerable efforts to support Amaggi's management of environmental and social issues, both for its own managed operations and within its supply chain.

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<sup>2</sup> The request was made by Peter Woicke during his tenure as IFC Executive Vice President, which ended in February 2005.

<sup>3</sup> IFC classifies projects as Category A, B or C depending on the anticipated scale and significance of the environmental and social impacts. This is discussed more fully in section 2.1.

<sup>4</sup> Available through the CAO's website ([www.cao-ombudsman.org](http://www.cao-ombudsman.org)).

The view of IFC staff was that wider issues raised by civil society (see below) were of much broader sectoral concern and therefore outside the scope of the Amaggi Expansion Project.

As noted by the Executive Vice President in his audit request, the project had been criticized by a number of civil society organizations, in particular Amigos da Terra (Friends of the Earth, Amazonia) who represented the Forestry Working Group of the Brazilian Forum of NGOs and Social Movements for Environment and Development (FBOMS<sup>5</sup>). The civil society criticisms of relevance to categorization included:

- That potential impacts were broader than IFC determined. The expansion of origination<sup>6</sup> activity involved a large number of unknown soybean farmers, and Amaggi's capacity to conduct soybean supplier due-diligence was unclear;
- That the project would enable Amaggi to establish a presence in growth areas in eastern Mato Grosso. Displacement of less profitable agricultural activities would indirectly lead to conversion of natural *cerrado* (Brazilian savannah) or forests to soybean cultivation;
- That IFC's categorization of the project did not take due account of publicly available information that attests to a rapid increase in deforestation within Mato Grosso, with soybean expansion as one of the drivers;
- That IFC's own procedures on categorization had not been followed, which require that an A categorization should apply to "large-scale agro-industry projects"; and
- That consultations conducted by Amaggi were inadequate as they were not project-related, and primarily part of a broader dialogue on the sustainability of the soy industry. Disclosure of information by IFC was inadequate.

On the basis of these concerns, which primarily relate to the indirect impacts of Amaggi's third-party soy suppliers, civil society organizations called for the project to be assigned a Category A rating. This divergence of opinion on the issue of categorization was central to the request from the Executive Vice President of IFC for CAO to audit IFC's categorization of the project<sup>7</sup>.

## 1.2 Scope of the audit

The scope of this audit is confined to an independent audit of the Amaggi Expansion Project's environmental categorization. Categorization occurs at an early stage in IFC's project review process and is an internal IFC decision made without reference to the client.

## 1.3 Key questions addressed by the audit

CAO adopted an approach consistent with IFC's own practices, by addressing the following questions:

- Did IFC follow its own procedures on categorization?
- Was IFC's categorization of the project as a Category B justified?

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<sup>5</sup> Fórum Brasileiro das Organizações Não Governamentais e Movimentos Sociais para o Meio Ambiente e o Desenvolvimento, a broad coalition of over 500 national NGOs ([www.fboms.org.br](http://www.fboms.org.br)).

<sup>6</sup> Origination refers to activities relating to sourcing soybeans for export, processing, trading, etc.

<sup>7</sup> Within IFC, the Environment and Social Development Department (CES) is responsible for project categorization and all aspects of IFC's environmental and social due diligence. Unless noted otherwise, references to IFC generally refer to CES staff.

To find answers to these questions, the CAO preformed a desk review of IFC project and other relevant documents, held discussions with IFC's Amaggi project team, and made field visits to Brazil. During field visits, CAO met with Amaggi personnel, World Bank staff from the Brasilia Field Office, and Brazilian civil society groups. (Annex 2 provides the audit method, and Annex 3 lists all organizations and sources consulted).

## 2. Context to the categorization audit

### 2.1 IFC's processes for project categorization and appraisal

**Categorization** occurs during IFC's internal process of 'Project screening', the purpose of which is to decide on the nature and extent of the environmental assessment (EA) needed for the project. The initial decision about project categorization occurs at a very early stage in IFC's project cycle. The rationale for categorization, including environmental and social issues and any policy concerns, are documented to assist management in decision-making.

Details of the categorization process, the distinctions between categories, and examples are outlined in IFC's 1998 ***Procedure for Environmental and Social Review of Projects***<sup>8</sup>, which is publicly available. The main distinction between an A or B categorization largely hinges on the question of impact significance, and specifically whether the impacts are likely to be "*sensitive, diverse or unprecedented*", in which case an A categorization should be assigned. IFC's Policy OP4.01 notes that "*sensitive, diverse or unprecedented*" impacts typically affect an area broader than the sites or facilities subject to physical works. A potential impact "*is considered 'sensitive' if it may be irreversible, (e.g. lead to loss of a major natural habitat)*". For category B projects, the environmental and social impacts are typically site-specific, are generally reversible, and are amenable to mitigation measures.

During **Project Appraisal**, IFC conducts a detailed assessment of the project, including environmental and social concerns. At this stage, IFC assures itself that its client has undertaken an appropriate level of Environmental Assessment (EA) and has in place the requisite capacity to deliver on environmental and social commitments. An IFC internal procedure (***Quality System Instruction # 8***) provide for projects to be re-categorized during appraisal (or at a later stage), in the event that project appraisal reveals a significant factor that was not available at the time of the initial categorization. The re-categorization process also provides for situations where projects may significantly change from the original proposed to IFC.

Categorization also has a bearing on, among other things, the level of public consultation and disclosure required of IFC and its client. For category A projects and B projects where there are "*special issues of concern*", IFC's clients can be required to implement additional measures such as meaningful consultation with relevant stakeholders.

### 2.2 IFC's loans to Amaggi and environmental & social due diligence

#### ***IFC's first loan to Amaggi***

IFC has made two loans to Amaggi, the first of which was approved in 2002 (Investment number 11344). This loan of \$30 million was directed to similar purposes as IFC's 2004 investment: (i) increasing permanent working capital; (ii) providing necessary liquidity levels to support the group's increasing annual crop and grower pre-financing requirements; and (iii) funding minor capital investments. The loan was assigned a category B rating, environmental and social due diligence commenced with a field visit in February 2002, and involved a significant level of effort until Board approval on June 25, 2002.

IFC's environmental and social appraisal explicitly recognized civil society concerns regarding the rapid expansion within the sector and the perceived linkages to *cerrado* and tropical moist forest conversion. It also identified a number of other concerns, such as the need to reinforce

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<sup>8</sup> Available at <http://www.ifc.org/enviro>

occupational health and safety controls, and referred Amaggi to all applicable environmental and social policies and guidelines at an early stage. IFC placed a strong emphasis on, and invested considerable efforts in, ensuring that Amaggi's own-managed farms and soy export and processing infrastructure complied with IFC's environmental and social requirements. As a condition of disbursement, IFC required Amaggi to develop and implement an Environmental and Social Management System (ESMS), for its own operations and critically, to extend this to its 900 pre-financed farms<sup>9</sup>. In this respect, IFC took the creative approach of treating Amaggi's pre-financing activities as analogous to an IFC financial intermediary client's on-lending activities<sup>10</sup>.

Amaggi's Environmental Management System includes 13 management programs, dealing with aspects such as: the legal and regulatory framework; worker health and safety; occupational health; and environmental evaluation. One of these management programs specified requirements for the environmental orientation of pre-financed suppliers. This addressed aspects such as: conducting technical inspections of pre-financed suppliers; training of pre-financed suppliers; and ensuring compliance with IFC's environmental and social requirements.

To ensure that IFC's environmental and social requirements were met by pre-financed suppliers, IFC required Amaggi to recruit full-time, qualified staff to 'screen' each pre-financing application, assess environmental and social risk and monitor performance. Specifically, the pre-financing contracts, Cedula de Produtor Rural (CPR) signed for each pre-financing agreement required farmers to confirm that they did not:

- engage in illegal deforestation nor grow soybeans on illegally deforested lands;
- utilize child labor;
- have pest management practices that contravened IFC's pest management policy (OP4.09 Pest Management);
- finance farms with land conflicts;
- adversely affect land belonging to indigenous peoples; and
- adversely affect conservation units (which includes avoiding designated protected areas and respecting natural habitat conversion restrictions in Brazilian law).

Additionally, farmers had to provide access to Amaggi for auditing purposes.

IFC documents reviewed indicate that 35% of suppliers (900 in total) were pre-financed, and supplied 65% of the total volume of soy originated by Amaggi (based on 2001 estimates). Amaggi's own-managed farms supplied 7.5% of soy originated, and the balance of 27.5% came from third-party farms that were not pre-financed. IFC's environmental and social professionals recognized that there may be environmental or social issues associated with the latter. They took the decision however, that neither IFC nor Amaggi had sufficient leverage to impose any special requirements on other third-party suppliers of soy, in light of the highly competitive commodity market situation that Amaggi operates within.

IFC's environmental and social staff and Amaggi's Senior Management recognized the potential value in broader engagement with NGOs in helping to bring about a wider sectoral commitment to responsible soy farming. In this regard, the IFC team engaged with the World Bank's Brasilia office

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<sup>9</sup> The number of farmers pre-financed by Amaggi varies year-on-year

<sup>10</sup> A significant percentage of IFC's lending is to third-party financial institutions, which then lend the money (on-lending) to selected clients. IFC requires that these financial institutions conduct environmental and social due-diligence of the clients they on-lend to.

during appraisal of the first loan, specifically on establishing a dialogue with NGOs around broader soy sectoral issues of mutual concern. Initial meetings with NGO's formed the basis for IFC's Corporate Citizenship Facility's (CCF's<sup>11</sup>) November 2003 proposal to Amaggi to broaden its engagement with Brazilian civil society organizations and the soy industry on Best Management Practices, developed in collaboration with IFC's project team and their counterparts at Amaggi.

### ***IFC's second loan to Amaggi***

The second Amaggi project (the Expansion project) was approved in September 2004, with an estimated cost of \$125 million, of which IFC provided \$30 million to: (i) finance additional soybean collection centers and associated silos that would add 250,000 tons of storage capacity in eastern Mato Grosso; and (ii) provide additional permanent working capital to support recurrent farmer pre-financing requirements and higher soybean origination volumes. Since the first IFC investment, Amaggi's permanent working capital had doubled, as a result of increased origination volumes and soy prices. Almost 90% of the overall budget for the Amaggi Expansion Project was to support third-party farmer pre-financing, with just 10% providing for additional storage and equipment purchases. Approximately 50% of IFC's loan went to each activity.

IFC investment staff met with Amaggi representatives in December 2003 when the possibility of a second loan was first discussed. At the end of January 2004, IFC initially signaled its willingness to consider a second loan to Amaggi. On a parallel track, IFC's CCF had moved forward with the proposal for Amaggi/CCF to stimulate a broader dialogue on responsible soy farming in Brazil. In addition, IFC provided support to Amaggi through CCF on developing written materials to promote good environmental practices in the soy production chain, in collaboration with a local foundation (The Mato Grosso Foundation). These materials were distributed at a series of events ("Soy Field Days 2005") in the cities of Mato Grosso and Mato Grosso do Sur, involving approximately 8,000 persons involved in soy production.

An important specific focus of IFC's appraisal was to obtain a fuller understanding of Amaggi's implementation of its ESMS, particularly with respect to social aspects. IFC hired a consultant in-country to undertake this work, from the consulting firm that Amaggi had contracted to help develop its ESMS initially.

The World Bank's Brasilia office was made aware of the proposed second Amaggi loan in mid-April 2004 during an information-sharing teleconference with IFC. Despite assurances from IFC that Amaggi were in compliance with IFC policies and guidelines and Brazilian legislation, the office registered a number of concerns with IFC. These included concerns that Amaggi's origination activities may be linked to increasing deforestation in Mato Grosso beyond its own-managed operations. From mid-April 2004 onwards, IFC's appraisal efforts were undertaken against a backdrop of exchanges with NGOs.

Amaggi's 2004 estimates for soy origination indicate that 25% of suppliers (500) were pre-financed and should supply 45% of the total volume of soy originated. The remaining 1500 suppliers that did not receive pre-financing were anticipated to supply 40%, while the balance of 15% would come from Amaggi's own farms. As previously outlined, IFC took the view that their due diligence (and that required of Amaggi) and outreach should be tailored to the diminishing level of influence and leverage IFC and Amaggi had at the level of their own managed operations, pre-financed suppliers and other third-party suppliers.

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<sup>11</sup> The CCF is a concessionary fund that works with IFC clients and other stakeholders to develop corporate citizenship initiatives that move beyond compliance with IFC environmental and social requirements.

### 3. Key Audit Issues

#### 3.1 Did IFC follow its own procedures on categorization?

This question is concerned solely with procedural compliance as opposed to the efficacy of the project categorization. For the Amaggi Expansion Project, IFC asserted that the internal debate around categorization involved extensive discussions. Little of that debate was captured in any of the documents required under IFC's Environmental and Social Review procedures. The PDS-ER (Project Data Sheet-Early Review) is the first point in IFC's project documents at which IFC's opinion on categorization is captured. This indicated that a B categorization should apply to the project. It stated that IFC had been working with Amaggi to help "*manage environmental and social risk in its operations*", including risks in its supply chain, and that "*an ESMS had been completed*". It also referenced IFC's support to the company on the dissemination and adoption of good practices'.

**CAO's analysis:** It is clear to CAO (from the review of project documents and discussions with the IFC Project Team) that IFC followed its own procedures on categorization. In advance of Board approval of the project, civil society organizations had raised concerns that IFC's own procedures on categorization had not been followed<sup>12</sup>. CAO accepts IFC's position that "large-scale agro-industry projects" is an indicative category, and that decisions on categorization should always depend on a case-by-case project-specific analysis. This is consistent with the approach outlined in Annex B to the ***Procedure for Environmental and Social Review of Projects***. IFC's procedures on categorization (see section 2.1) are loosely defined however, and implicitly rely heavily on professional discretion. As IFC's procedures do not provide for in-depth public disclosure around decisions on categorization, it is not possible for interested or affected parties to make an informed judgment about IFC's decision-making process.

#### 3.2 Was IFC's categorization of the project as Category B justified?

IFC had detailed knowledge of the potential impacts of Amaggi's own-managed operations based on its engagement with Amaggi during the first IFC loan. It had also required Amaggi to implement an Environmental and Social Management System (ESMS), to address the impacts of its own-managed operations and those associated with pre-financed suppliers. The only new infrastructure to be financed under the new loan was the construction of three soy storage silos. The precise locations of the silos had not been identified at the time of the loan being approved. As part of its appraisal process, IFC hired a consultant to determine "*the degree to which the ESMS had been integrated into company operations and how well it functions in regards to its objectives*"<sup>13</sup>. IFC also identified a list of issues for which IFC needed to obtain a clearer understanding of during appraisal, some of which referred to Amaggi's own-managed operations and some of which referred to application of the ESMS to pre-financed suppliers. The Environmental Review Summary for the project (which was publicly disclosed) states that "*IFC is fully satisfied with the company's efforts to date to develop and implement the ESMS and with the system's ability to assist the company maintain compliance with Brazilian regulatory and IFC policy and guideline requirements*". At a later stage of appraisal, IFC identified the need for Amaggi to produce and implement a Public Consultation and disclosure plan.

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<sup>12</sup> Specifically, Civil society organizations cited Annex B to IFC's ***Procedure for Environmental and Social Review of Projects***, which they interpreted as requiring an A categorization to apply to large-scale agro-industry projects'.

<sup>13</sup> IFC internal memorandum dated 03/09/2004

**CAO's analysis:** Recognizing that the process of categorization involves professional judgment, CAO considers that a B rating could have been justified had IFC adequately assured itself during appraisal<sup>14</sup> that:

1. Amaggi's own-managed operations were in compliance with IFC's environmental and social requirements;
2. The potential impacts of new infrastructure (specifically soy storage silos) would be adequately addressed prior to construction;
3. The ESMS would ensure compliance with IFC's environmental and social requirements and afford an appropriate level of environmental and social protection;
4. Satisfactory progress had been made with implementing Amaggi's Environmental and Social Management System (ESMS), required as a condition of IFC's first loan to Amaggi; and
5. An opportunity had been provided for public consultation, in light of the heightened concerns regarding conversion of natural habitats for soy cultivation<sup>15</sup>.

Each of these points is discussed in more detail below.

**1. Did IFC assure itself that Amaggi's own-managed operations were in compliance with IFC's environmental and social requirements?** IFC went to considerable efforts to determine whether Amaggi's own-managed operations were in compliance with applicable safeguard policies and guidelines. The due-diligence for the first and second loan included: several visits to/audits of Amaggi facilities by IFC staff and consultants; ensuring that Amaggi's own managed farms were in compliance with Brazilian legal and regulatory requirements, or had a commitment to compliance within a specified time-frame; supporting the development of an extensive ESMS to comprehensively address the impacts of own-managed operations; requiring a reinforcement of Amaggi's capacity for environmental and social management; and conducting additional checks on the status of corrective actions.

**CAO's analysis:** Over the course of its engagement with Amaggi, IFC has taken steps to assure itself that the impacts of Amaggi's own-managed operations are in compliance. In addition, it has encouraged and supported the company to engage in social responsibility initiatives, and the development and dissemination of good practices for soy cultivation.

**2. Did IFC assure itself that the potential impacts of construction of soy storage silos would be adequately addressed?** As the preferred silo locations had not been identified at the time of loan approval, IFC required Amaggi to commit to producing an assessment study of the proposed infrastructure expansion program. IFC considered the impacts of silo construction to be localized and amenable to standard mitigation methods. IFC included the requirement to produce the assessment study within the Corrective Action Plan (CAP) for the project, which was covenanted to the loan agreement between IFC and Amaggi. IFC reviewed the report subsequently submitted by Amaggi and determined it to be adequate.

**CAO's analysis:** IFC took steps to ensure that the localized impacts of new infrastructure would be addressed. IFC should have more clearly defined the scope for the assessment study and its expectation in terms of issues to be addressed and level of detail required.

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<sup>14</sup> Appraisal is the process whereby IFC determines in detail whether a project fully complies with all of IFC's applicable environmental and social requirements.

<sup>15</sup> Although public consultation is discretionary for category B projects, IFC can require consultation where it determines that there are 'special issues of concern'.

**3. Did IFC assure itself that the ESMS would ensure compliance with IFC’s environmental and social requirements and afford an appropriate level of environmental and social protection?** IFC invested considerable resources in providing support to Amaggi with ESMS implementation, which continued beyond the approval of the second loan. In particular, IFC ensured that the pre-financing contracts (CPRs) signed for each third-party supplier required farmers to confirm that they did not engage in activities that might have brought them into conflict with IFC’s environmental and social Safeguard Policies. Specifically, pre-financed suppliers had to commit not to: engage in illegal deforestation or grow soybeans on illegally deforested lands; utilize child labor; contravene IFC’s pest management policy; finance farms with land conflicts; adversely affect land belonging to indigenous peoples; or adversely affect conservation units.

It is clear to the CAO that IFC had an informed understanding of the broader environmental and social concerns relating to soy expansion, although IFC considered that the specific impacts associated with Amaggi’s pre-financed suppliers would be addressed through the company’s ESMS. IFC emphasized that its investment would not fund any activity directly associated with the expansion of soybean production, as Amaggi operated within a highly competitive market situation. This means that if Amaggi were to cease operations, its competitors would purchase the soy produced by Amaggi’s third-party suppliers, resulting in the same level of soy production taking place as in a “without project” scenario. IFC stated that it has become established practice to apply this logic and approach to categorization when dealing with the supply chain impacts of agribusiness projects, where IFC clients source raw materials from multiple farmers/producers in competitive commodity markets<sup>16</sup>. IFC also makes a distinction between Environmental Assessment (EA) requirements determined through project screening, and its subsequent management of environmental risks.

**CAO’s analysis:** The basic provisions of the ESMS should be sufficient to ensure ongoing compliance with IFC’s environmental and social requirements, subject to: (i) satisfactory progress with implementation of the ESMS (discussed in point 4 below); and (ii) IFC having an informed understanding of pre-financed supplier impacts, for example on natural habitats. Amaggi has undertaken supplier profiling to establish a baseline to be able to monitor continuous improvements achieved through its management system over time<sup>17</sup>. While this served the purpose of the procedural requirements of the ESMS, it did not provide sufficient information to enable IFC to make an informed decision on the nature and magnitude of the potential impacts on natural habitats of land use (and in particular land clearance) by pre-financed suppliers. It did not look at the types, extent of, or significance of habitat loss through a consistent frame of reference using qualified professionals, nor did it provide a consistent assessment of the compliance of pre-financed suppliers with host country laws or IFC’s Safeguard Policies and guidelines. As part of its appraisal of the project, IFC should have required a more thorough analysis be conducted as:

- In the case of the Amaggi Expansion Project, IFC financing has been used to support pre-financing of farmers. This direct link has not always been the case with other IFC projects where the approach to categorization outlined above has been adopted;

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<sup>16</sup> IFC provided details of several other agribusiness projects where the same approach has been applied to categorization with respect to supply chain impacts. The exception is where the project involves trade in sensitive products (such as tropical hardwoods) where the IFC require some form of chain-of-custody certification. While this practice has not yet been reflected in any sectoral guideline or other document provided to the CAO, CAO recognizes that it has become established practice within IFC.

<sup>17</sup> A ‘baseline’ **Environmental Profile of Pre-financed Suppliers** was produced by Amaggi in 2004 with support from 23 undergraduates of the Federal University of Mato Grosso. This was publicly disclosed as part of the Public Consultation and Disclosure Plan (PCDP) of Amaggi.

- In situations where suppliers operate in environmentally or socially sensitive areas (such as parts of Mato Grosso) IFC's financing could support activities that are contrary to its Safeguard Policies or guidelines;
- In the absence of a proper baseline for environmental assessment, there is no rational basis for monitoring the effectiveness of these mitigation measures. As a consequence, neither IFC nor Amaggi can ever credibly demonstrate to critics that mitigation efforts have truly been effective.
- Linked to the previous bullet point, CAO finds IFC's distinction between EA requirements and risk management measures (such as Amaggi's ESMS) to be arbitrary, as in the absence of a baseline, the effectiveness of risk management measures can not be effectively monitored.

In summary, IFC did not adequately assure itself that the ESMS would ensure compliance with IFC's environmental and social requirements and afford an appropriate level of environmental and social protection. Given the broader environmental, social, and regulatory/enforcement context within Mato Grosso, the potential for Amaggi's pre-financed suppliers to contribute to conversion of natural habitats should have been more robustly assessed.

**4. Did IFC adequately assure itself of the status of implementation of Amaggi's ESMS?** As part of its appraisal, IFC hired a consultant to determine the degree to which the ESMS had been integrated into Amaggi's operations, and how well it functioned in regard to its objectives. The Terms of Reference (TOR) for the consultant primarily focused on: (i) assessing the social dimensions of the system, with reference to indigenous organizations and communities; and (ii) meeting with a sample of company warehouse managers and pre-financed farmers. Based on the findings of the consultants report, IFC engaged in meetings and discussions with Amaggi to discuss necessary measures to reinforce the ESMS. These were included in the revised Corrective Action Plan, which was covenanted to the loan agreement. IFC was satisfied that it had assured itself of the status of implementation of the ESMS.

**CAO's analysis:** IFC should have undertaken a more rigorous assessment of the status of implementation of the ESMS as part of its appraisal of a second loan. The consultant report on the ESMS was limited by the TOR established by IFC. This ought to have included visits to/audits of a representative number of Amaggi's pre-financed suppliers, and considered the extent to which environmental and social provisions of the ESMS were understood, being implemented, and were having the intended outcome in terms of compliance and environmental and social protection. From CAO's review of a subset of suppliers, it appears that there may well be systemic weaknesses with the implementation of the ESMS, which could undermine the ability of the ESMS to provide an appropriate level of environmental and social protection or regulatory compliance.

**5. Had an opportunity been provided for public consultation, in light of the heightened concerns regarding conversion of natural habitats for soy cultivation?** Concerns were raised by civil society organizations that challenged the efficacy of IFC's categorization decision and appraisal from a fairly early stage. Although not mandated for category B projects by IFC's **Procedure for Environmental and Social Review**, IFC required Amaggi to prepare and implement a Public Consultation and Disclosure Plan (PCDP). The PCDP: described the expansion project and IFC's involvement; provided some regulatory context and details of IFC's environmental and social requirements; presented information on the Amaggi ESMS; outlined the proposed public consultation program and timetable; and outlined the details of the grievance mechanism established by Amaggi as part of its ESMS.

**CAO's analysis:** Amaggi went to considerable efforts to ensure a broad set of stakeholders were directly invited to and/or aware of these meetings. The consultations presented an adequate opportunity to discuss wider NGO concerns, as informed and aware civil society organizations at

the national level were invited to the consultations and in a position to advise local-level organizations of the value in raising concerns locally. On balance, despite some perceived ambiguity regarding the scope of the consultations, they provided a reasonable opportunity for concerns to be raised by civil society participants.

## 4. Findings and recommendation

### 4.1 Findings

CAO recognizes: (i) a continuum rather than a strict boundary between A and B projects inherent in IFC's *Procedure for Environmental and Social Review of Projects*; and (ii) that the procedures allow for professional discretion and flexibility in the assignment of a project to a Category based on adequate assurances that expected impacts can be mitigated.

On the question of **whether IFC followed its own procedures on categorization**, CAO finds that IFC did follow its categorization procedures. CAO also finds that IFC:

- Has procedures for categorization that are loosely defined and rely heavily on professional discretion;
- Has an informal “established practice” on categorization to address the supply chain impacts of agribusiness projects that may not be fully supportive of a robust appraisal process; and
- Does not provide for disclosure around categorization decisions that would enable interested or affected parties to make an informed judgment about the adequacy of IFC's categorization decisions.

On the related question of **whether IFC's categorization of the project as Category B was justified**, CAO finds that IFC:

- Required that Amaggi implement an ESMS in order to mitigate potential adverse social and environmental impacts;
- Assured itself that Amaggi's own-managed operations were in compliance with environmental and social requirements;
- Assured itself that the potential impacts of construction of soy storage silos could be adequately addressed through an EA; and
- Required Amaggi to provide a reasonable opportunity for meaningful discussion of civil society.

CAO also finds that IFC:

- Did not adequately assure itself of whether or not the ESMS would afford an appropriate level of environmental and social protection, and ensure compliance with IFC's environmental and social requirements during project appraisal;
- Did not undertake a sufficiently rigorous assessment of the status of implementation of Amaggi's ESMS as part of its appraisal of the second loan; and
- Did not clearly define its expectations of Amaggi as regards issues to be addressed by the assessment of the proposed silo locations and the required level of detail.

CAO finds that the Category B rating can not be fully justified unless these conditions are met.

### 4.2 Recommendation

**CAO recommends that IFC prepares and publicly discloses a note on the actions it intends to take in response to the audit findings.**

## Annex 1: Request for Audit

THE WORLD BANK/IFC/M.I.G.A.

# OFFICE MEMORANDUM

DATE: November 1, 2004

TO: Meg Taylor, Compliance Advisor/Ombudsman, CCAVP

FROM: Peter L. Woicke, Executive Vice President, CEXVP

EXTENSION: 30381

SUBJECT: Request for an Independent Audit of the Environmental Categorization of the Amaggi Project

1. This memo is to request you to carry out an audit of the environmental categorization of the Amaggi Project in Brazil (project #22561) which was approved by the Board on September 23, 2004.
2. Amaggi Exportação e Importação Limitada (Amaggi), an existing client of IFC, is one of the leading soybean operators in the Mato Grosso state of Brazil. The company's main activities are pre-financing farmers, procurement of soybeans, soybean crushing and export of soybeans and soybean products. The proposed project is expected to cost US\$125 million and the IFC A loan of up to US\$30 million will be used to support the higher working capital and silo capacity requirements of the Company.
3. While deforestation in the Amazon region is understood to be the result of various factors, expansion of soybean cultivation in the center-west of Brazil has been identified as being, at least indirectly, one of the contributing factors. Due to this reason, it has been perceived by the NGO community that the expansion of Amaggi's operations could contribute further to the deforestation. However, the proposed project will not fund any activity directly associated with the expansion of soybean production as IFC is providing funds for working capital and construction of soybean storage silos. In addition, IFC's comprehensive environmental due diligence of the proposed project concluded that the direct impacts of the proposed investment (working capital and soybean storage silos) are manageable by adhering to generally recognized performance standards, guidelines or design criteria. The project was thus classified as Category "B". Nevertheless, a number of NGOs have since objected to the categorization of this project by IFC and have insisted that the project should have been classified as Category "A" since it is in an area prone to deforestation and IFC's project could indirectly add to such a deforestation.

October 27, 2004

4. In view of the above, I kindly request you to carry out an independent assessment of the project's environmental categorization. You can be assured that IFC will fully cooperate with you and your staff in providing all the relevant information needed to facilitate such an assessment.

Please do not hesitate to contact me if there are any issues you need to discuss before commencing your audit.

cc: Messrs/Mmes. A. Jabre J. Sullivan, JP. Pinard, A. Mehta, R. Kyte, W. Bulmer, O. Chemerinski, M. N'Daw, S. Kebet-Koulibaly, S. Pimenta, A. Naqvi, D. Vallada-Neto, J. Doumbia, J. Butler, K. Lim

## Annex 2: Audit Method

The specific tasks undertaken by the CAO were as follows:

1. **Conducted an initial review of the issues and concerns raised by NGOs** in the correspondence dating between May 7, 2004 and October 25, 2004 in order to understand the nature of civil society concerns.
2. **Engaged in initial discussions with the IFC project team** to establish points of contact with key personnel, obtain their first hand account of the project background and the soy sector more generally, explain the CAO's approach to auditing, initially explore the concerns raised by NGOs, and identify information requirements.
3. **Engaged in initial discussions with Amigos da Terra** to obtain a fuller understanding of the nature and extent of NGO concerns, consider optimal timing for visits to Brazil (Sao Paulo and Mato Grosso), and outline the overall CAO approach to auditing.
4. **Engaged in initial discussions with Amaggi** to introduce the CAO and its auditing role, obtain an initial understanding of Amaggi's approach to the management of environmental and social issues, and discuss optimal timing for visits to Mato Grosso.
5. **Conducted a detailed review of project documents** to better understand IFC's approach to and rationale for categorization, supplemented by additional discussions with the project team.
6. **Designed the specific approach that CAO adopted for the audit**, including the basic questions to be addressed (as outlined below), the timing of visits to Brazil and particularly to Mato Grosso, and the specific focus on (and actions to be undertaken) regarding Amaggi's environmental and social due diligence of its pre-financed suppliers.
7. **Produced a Terms of Reference, for and contracted with ERM, a Brazilian environmental consulting firm**, to conduct a more detailed assessment of Amaggi's due diligence of pre-financed suppliers.
8. **Met with a number of civil society organizations in Brazil**, at the national level in Sao Paulo and Brasilia and at the state level in Cuiaba, to better understand the nature of civil society concerns regarding IFC's due diligence and/or Amaggi's operational activities. In addition, meetings or telephone conversations were had with key personnel within the World Bank's Brasilia office.
9. **Met with Amaggi's management team in Rondonopolis** and conducted detailed discussions regarding the application of Amaggi's ESMS to pre-financed suppliers, independently selected a sample of pre-financed farms to visit (in the municipalities of Tapurah, Sorriso and Ipiranga do Norte), and field-tested the protocols for subsequent visits to a sample of approximately 30 pre-financed farms.
10. **Conducted independent field-visits to Amaggi's pre-financed farms** to independently assess Amaggi's due diligence of pre-financed farmers, in support of the overall assessment of project categorization.
11. **Critically reviewed** meeting notes and any additional documents received in advance of preparing the report of the categorization audit.

12. ***Prepared report and submitted it for factual comment*** to IFC and Amaggi, prior to finalization and public disclosure by the CAO, in English and Portuguese. The purpose was to provide IFC and Amaggi an opportunity to check for factual inaccuracies, not to negotiate findings or recommendations.

## Annex 3: Organizations and Sources Consulted

### Organizations

Amaggi Exportação e Importação (Amaggi) [www.grupomaggi.com.br](http://www.grupomaggi.com.br)

Amigos da Terra (Friends of the Earth Amazonia) [www.amazonia.org.br](http://www.amazonia.org.br)

Central Unica dos Trabalhadores [www.cut.org.br](http://www.cut.org.br)

Fórum Brasileiro de ONGs e Movimentos Sociais para Meio Ambiente (FBOMS)  
[www.fboms.org.br](http://www.fboms.org.br)

Fórum de Combate ao Trabalho Escravo [cbfj@brturbo.com](mailto:cbfj@brturbo.com)

Fórum Matogrossense de Meio Ambiente e Desenvolvimento (Formad) [formad@terra.com.br](mailto:formad@terra.com.br)

Fundação Centro Brasileiro de Referência e Apoio Cultural (CEBRAC) [www.cebrac.org.br](http://www.cebrac.org.br)

Grupo de Trabalho Amazônico (GTA) [gtamt@terra.com.br](mailto:gtamt@terra.com.br)

JGP Consultores (Consultants to Amaggi and to IFC)

IFC project team [www.ifc.org](http://www.ifc.org)

Instituto Socioambiental (ISA) [www.socioambiental.org](http://www.socioambiental.org)

World Bank (Brasilia Office) [www.worldbank.org](http://www.worldbank.org)

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Fundação Estadual do Meio Ambiente (FEMA) [www.fema.mt.gov.br](http://www.fema.mt.gov.br)

Instituto Nacional de Pesquisas Espaciais (INPE) [www.inpe.br](http://www.inpe.br)

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Worldwide Fund for Nature-Brazil (2003). Sustainability assessment of export-led growth in soy production in Brazil.