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AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE AUDITOR GENERAL, EAST ASIA
Manila, Philippines

PD-AAJ-408
ISN 904

Ramon Magsaysay Center
1680 Roxas Boulevard

Telephone: 59-80-11

December 14, 1970

Mr. Thomas C. Niblock
Director
USAID/Philippines
c/o American Embassy
Manila, Philippines

Dear Tom:

Re: Rural Electrification Cooperatives
AID Loan No. 492-H-026 (MORESCO)
31 August 1968 to 31 October 1970
Audit Report No. 8-492-71-45

We have performed an initial examination of the Rural Electrification Cooperatives (MORESCO) Project under AID Loan No. 492-H-026 to review implementation progress and compliance with loan agreement terms, and to identify any significant problem areas requiring corrective attention. Our examination covered project activities from inception, 31 August 1968, to 31 October 1970. We reviewed records, reports and correspondence at the Mission and MORESCO; held discussions with various project officials; and, performed other audit procedures deemed necessary under the circumstances. Inasmuch as the accounting functions for the loan are being performed by AID/W, we did not examine the loan accounting records or disbursements thereunder.

To assist the Republic of the Philippines (RP) with its rural electrification program, AID provided the RP with a team of consultants from the National Rural Electrification Cooperative Association (NRECA), Washington, D. C., who prepared feasibility studies in 1967 and 1968 for two pilot rural electric service cooperative projects located at Victorias, Negros Occidental Province (VRESCO) and between Iligan and Cagayan de Oro on the island of Mindanao (MORESCO). As a result of the latter study, AID Loan Agreement

No. 492-H-026 was subsequently negotiated on 31 August 1968 between the Development Bank of the Philippines (DBP - Borrower), the Misamis Oriental Rural Electric Service Cooperative (MORESCO - Beneficiary), and the United States thru AID. Under the loan agreement, an amount of up to \$1,100,000 is to be provided to the DBP, an RP wholly-owned banking corporation, for re-lending to MORESCO to cover the foreign exchange costs of design and construction for the transmission and distribution of electricity.

The project is located in Misamis Oriental Province on the island of Mindanao and presently involves ten municipalities located between the cities of Iligan and Cagayan de Oro. The National Power Corporation (NPC) presently provides electric power from its Maria Cristina plant in Iligan to Cagayan de Oro via a transmission line. Under the AID loan project, it is planned to tap this transmission line to provide electricity to approximately 5,460 consumers. This will involve basically the construction of a distribution system consisting of two substations and 500 miles of lines, and MORESCO headquarters buildings to be located in the municipality of Laguindingan near Cagayan de Oro.

The loan, at 3-1/2% interest, is to be repaid to AID within 25 years in 41 semi-annual installments commencing five years after the first loan disbursement. The financial status of the loan as of 30 September 1970 is as follows based on AID/W information:

Loan Ceiling	\$1,100,000
Committed thru L/Comm's	\$ 861,790
Disbursements	\$ 173,121

Our examination disclosed that the financial support to be provided to the project by the AID loan and the RP is presently inadequate due to inflation and RP peso devaluation which has occurred since the loan agreement date; and to a closer defining of project requirements which has added costs not included in original cost estimates. The AID loan agreement was dated 31 August 1968 and presently contains a ceiling of \$1,100,000 and condition precedent requirements for the borrower, DBP, to hold on deposit ₱2,137,029 of local currency for use on the project, plus an RP commitment that it will provide all funds (in addition to the Loan and funds deposited with Borrower pursuant to the Loan) and other resources required for the timely implementation of the project. The final design of the MORESCO Basic

System was initially prepared in October 1969 by Yost Associates, Inc., the U. S. consulting engineer for the project, and was subsequently revised in August 1970. Revisions were made to incorporate cost increases due to inflation; RP peso devaluation which took place in February 1970; approximately nine months of slippage due to lack of familiarization with AID loan requirements and RP field conditions; additional requirements not included in the original cost estimates; and, a closer determination of costs thru procurement accomplished to date. Based on the Yost System Design Report amended as of August 1970, the estimated dollar and peso requirements, and resulting shortfall for the project are presently as follows:

	<u>Dollar Portion</u>	<u>Peso Portion</u>
Estimated Costs Per Yost System Design Report as Amended August 1970	\$1, 327, 634	₱3, 042, 510
Available Funds - AID Loan	1, 100, 000	
Available Funds - NEA Loan*	<u> </u>	<u>2, 137, 029</u>
Estimated Shortfall	<u>\$ - 227, 634</u>	<u>₱ 905, 481</u>

*RP National Electrification Administration
8/31/68, 25 years, 3% loan to MORESCO.

To cover the anticipated shortfall, MORESCO made written requests on 2 September 1970 to the NEA, and the DBP thru USAID for additional loan funds. The USAID NRECA advisors have informed us that no problems are anticipated regarding the additional dollar requirements from AID/W, and that the advisors and MORESCO are presently meeting with the NEA and DBP to obtain the necessary increase in the peso loan funds. In view of the corrective action being applied by MORESCO and the Mission, no audit recommendations are deemed necessary at this time.

The examination also disclosed that the clearing of the right of way for the project is requiring considerable effort due to refusals by a number of residents to allow their coconut trees to be cut down for the

establishment of the distribution lines. The USAID NRECA advisors and MORESCO advised us that they were well aware of the potential gravity of this problem as to possible future project delay, but that the problem can be, and is being, solved thru various methods such as personal persuasion by MORESCO and Administration officials, condemning necessary land thru exercising the right of eminent domain, and diverting lines where necessary. Thus far, only persuasion has had to be used; and, successful results are being obtained per the NRECA. In view of MORESCO's and the Mission's active awareness of the right of way problem and the action being taken, no audit recommendation is presently necessary.

Sincerely yours,

Frank Harrison
Francis M. Harrison
Area Auditor General
East Asia

Enclosure:
Schedule I - Report Distribution

RURAL ELECTRIFICATION COOPERATIVES
AID LOAN NO. 492-H-026 (MORESCO)

SCHEDULE I

REPORT DISTRIBUTION

	<u>No. of</u> <u>Copies</u>
<u>IGA</u>	1
<u>AID/W</u>	
AG/AUD	3
EA/Phil	1
EA/PMCA	2
EA/CDF	1
<u>HS/Korea</u>	1
<u>USAID/P</u>	5
<u>AG/EA</u>	
Area Audit Office	5
Philippines Residency	1

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ISN 904

PD-AAJ-408

Evaluates project to assist the Misamis Oriental Rural Electric Service Cooperative (MORESCO) to design and construct facilities for transmitting and distributing ^{onespaceonly.} electricity. Audit report covers the period 8/31/68-10/31/70 and is based on document review and discussions with project officials.

As of 9/30/70, \$1,034,911 of the \$1.1 million loan has been committed or disbursed.

Financial support for the project from A.I.D. and the Republic of the Philippines (RP) is considered inadequate due to inflation and devaluation of the RP peso, and to added costs derived from closer defining of project requirements. Although the project was revised to incorporate these additional costs, there remains a shortfall of \$227,634 and 905,481 RP pesos, which is expected to be covered by A.I.D., the Development Bank of the Philippines, and the National Electrification Administration.

Possible project delay^S caused by residents' refusal to permit coconut trees to be cut down is being handled by personal persuasion, exercising the right of eminent domain to condemn land, and diverting lines where necessary.

Done
Draft # F

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PD-AAJ-408

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