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AUDIT OF
RAPTI ZONE RURAL AREA DEVELOPMENT
PROJECT IN NEPAL
PROJECT NO. 367-0129

Audit Report No. 5-367-87-2
December 31, 1986

memorandum

DATE: December 31, 1986
REPLY TO: *James W. Widdows*
ATTN OF: James W. Widdows, RIG/A/Singapore, Acting

SUBJECT: Audit of the USAID/Nepal's Rapti Zone Rural Area Development
(Project No. 367-0129)

TO: Mr. David M. Wilson, Director, USAID/Nepal

This report presents the results of an audit of USAID/Nepal's Rapti Zone Rural Area Development Project (No. 367-0129). The program results audit was made to measure the progress and effectiveness of the Project, evaluate USAID/Nepal's management of the Project, and review compliance with AID policies and regulations.

The Rapti Zone Rural Area Development Project has met many of the Project objectives but has not met its principal agricultural production objectives. Nevertheless, the Project has built a solid base for future development activities. USAID/Nepal's management of the Project has been satisfactory. In implementing the Project the Mission has complied with AID policies and regulations.

The plans for the Rapti Zone Rural Area Development Project were general and overly optimistic, were not strongly focused on project purposes, and did not provide effective strategies for dealing with the implementation constraints in the remote hill areas. His Majesty's Government of Nepal has not effectively managed the local currency that was supplied to support project activities. Analysis of the financial statements of the Rapti Zone Branch of the Agricultural Development Bank raised questions concerning the Branch's management. The Project's long-term training requirements have contributed little to strengthening the manpower resources of the Rapti Zone, and an assessment survey of the Rapti Zone roads has not been used.

We recommend that in the follow-on Rapti Zone Project USAID/Nepal make provisions for dealing with the major implementation constraints to increasing agricultural production, including a mechanism for using technology from the USAID/Nepal Agricultural Research and Production Project and other research projects. We recommend training for

Project financial staff and revised procedures for handling questioned costs. We recommend a review of the financial and management practices of the Rapti Zone Branch of the Agricultural Development Bank. We recommend that USAID/Nepal limit more of the Project funded long-term training to people who have served in the Rapti Zone or agreed to serve there at the end of the training. Finally, we recommend requesting a refund for the cost of the unused road assessment survey.

USAID/Nepal concurred with all of the recommendations except the last one for requesting a refund for the cost of the unused road assessment survey. USAID/Nepal agreed that the assessment should be used, but did not agree that they should request a refund if the assessment is not used. The IG position is that the possibility of a refund should be used to encourage His Majesty's Government of Nepal to build the roads included in the assessment.

Please provide written notice within 30 days of any additional information related action planned or taken to implement the recommendations.

EXECUTIVE SUMMARY

The Rapti Zone Rural Area Development Project was designed as a multi-sectoral development project to improve farming systems, renewable resource management, small rural works, employment and skills development, and institutional development in Nepal's Rapti Zone. The grant agreement for \$26.7 million was signed August 12, 1980, and the Project completion date was July 30, 1987.

The Office of the Regional Inspector General for Audit/Singapore made a program results audit of the Rapti Zone Rural Area Development Project to review AID's assistance to His Majesty's Government of Nepal's development program in the Rapti Zone. The specific audit objectives were to measure the progress and effectiveness of the Project, evaluate USAID/Nepal's management of the Project, and review compliance with AID policies and regulations.

The Rapti Zone Rural Area Development Project has met many of the Project objectives but has not met its principal agricultural production objectives. Nevertheless, the Project has built a solid base for future development activities. USAID/Nepal's management of the Project has been satisfactory. In implementing the Project the Mission has complied with AID policies and regulations.

The Rapti Zone Project area is in one of the most remote and disadvantaged parts in Nepal. The Project has introduced a variety of development activities to the area, and even though some of these activities will not be included in the follow-on project the Project has helped improve the lives of the people living in the area.

The plans for the Rapti Zone Rural Area Development Project were general and overly optimistic, were not strongly focused on project purposes, and did not provide effective strategies for dealing with the implementation constraints in the remote hill areas. His Majesty's Government of Nepal has not effectively managed the local currency that was supplied to support project activities. Analysis of the financial statements of the Rapti Zone Branch of the Agricultural Development Bank raised questions concerning the Branch's management. The Project's long-term training requirements have contributed little to strengthening the manpower resources of the Rapti Zone, and an assessment survey of the Rapti Zone roads has not been used.

The AID Handbook required that project papers include well developed plans for implementation. The plans for the Rapti Zone Rural Area Development Project were general and overly optimistic, were not strongly focused on Project purposes,

and did not provide effective strategies for dealing with the implementation constraints in the remote hill areas. The overly optimistic project plans were the result of using unwarranted assumptions and failing to take into account the difficulties involved in implementing a complex project in a very remote area. As a result the Project has not met its agricultural production objectives, and implementation has been delayed. We recommend that in the follow-on Rapti Zone Project, USAID/Nepal make provisions for dealing with the major implementation constraints to increasing agricultural production, including a mechanism for getting technology for the Rapti Zone from the USAID/Nepal Agricultural Research and Production Project and other appropriate research projects. USAID/Nepal concurs with the recommendation.

USAID/Nepal has provided \$9.6 million in local currency to support Project activities. The grant agreement required His Majesty's Government of Nepal to manage the Project effectively. The Project local currency has not been well managed, principally because His Majesty's Government of Nepal has been unable to assign to the Project the trained people needed for effective management. Also, communication between His Majesty's Government of Nepal's field organizations has been weak; the District Treasury Offices have not been advising the Project Coordinator's Office when they questioned costs. As a result, the release of Project funds was delayed, and questioned costs were reimbursed by USAID/Nepal. We recommend training for Project financial staff and improving communication procedures for handling of questioned costs. USAID/Nepal concurs with the recommendation pertaining to training for Project financial staff. Regarding the recommendation for handling of questioned costs, USAID/Nepal indicated they have had no knowledge of any costs questioned by agencies of His Majesty's Government of Nepal.

As part of the Rapti Zone Rural Development Project's agricultural credit program, USAID/Nepal provided \$920,000 to the Agricultural Development Bank for making loans to small farmers and cooperatives in the Rapti Zone. The grant agreement required His Majesty's Government of Nepal to ensure that the Project was conducted using sound financial and management practices. A review of the financial statements of the Rapti Zone Branch of the Agricultural Development Bank showed that it had a negative current ratio, and its expenses as a percentage of income were on the rise. This poor performance was caused by increases in both delinquencies and interest expenses. If these problems are not corrected it may not be possible to continue the credit program in the Rapti Zone. We recommend an evaluation of the Bank's capability to sustain the credit program. USAID/Nepal concurs with the recommendation.

The long-term training objectives of the Project are to increase the technical and management skills in the Rapti Zone and to reward people for serving there. Most of the people selected for long-term training neither served in the Rapti Zone prior to training nor were they assigned there on completion of training. The Project training plans did not include provisions for using Project funded training to build institutions in the Rapti Zone. As a result, the \$415,000 spent for long-term training has added little to the development skills in the Rapti Zone. We recommend that USAID/Nepal limit long-term training to people who have served in the Rapti Zone or have agreed to serve there when their training is completed. USAID/Nepal concurs with the recommendation.

USAID/Nepal paid \$642,000 for a road assessment survey that has not been used. The grant agreement requires His Majesty's Government of Nepal to use resources provided under the grant to further the objectives of the Project. His Majesty's Government of Nepal has not actively sought donor assistance for constructing the roads. If the roads are not constructed, the funds for the study will not have been used to further Project objectives and many development activities in the Rapti Zone will be delayed. We recommend that USAID/Nepal request a refund for the cost of the unused assessment survey. USAID/Nepal agreed that the assessment should be used, but did not agree that they should request a refund for the cost of the study.

Office of the Inspector General

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PART I - INTRODUCTION

A. Background

The Rapti Zone is an area of approximately 4,000 square miles in west-central Nepal, bordering India on the south and the Himalaya Mountains on the north. The population of the area is now estimated at one million and Nepal's population is increasing 2.7 percent annually. Nepal, with a per capita income of \$160, is one of the poorest countries in the world, and incomes in the Rapti Zone, especially in the hill areas, are well below the national average.

The Rapti Zone Rural Area Development Project was a multi-sectoral development project designed to improve farming systems, renewable resource management, small rural works, employment and skills development, and institutional development at the local level. The objectives of the Project were:

- to increase production and consumption of food,
- to increase employment opportunities and average labor productivity,
- to strengthen the capacity of village and district organizations to plan, implement, and evaluate development activities,
- to increase availability and local utilization of national delivery systems.

The Project grant agreement specifying that AID would provide \$26.7 million and His Majesty's Government of Nepal (HMG/Nepal) \$7 million was signed August 12, 1980; the Project Assistance Completion Date was September 30, 1985 and was extended to July 30, 1987. Project implementation was under the direction of HMG/Nepal's Ministry of Panchayat and Local Development (MPLD). The MPLD's Project Coordinator's Office (PCO) located in Tulsipur was responsible for the coordination of Project activities within the Rapti Zone. Technical assistance was provided by Planning and Development Collaborative International (PADCO) under a contract executed on May 22, 1981 that had an amended value of \$3.9 million. The Project was considered the first phase of a 15 to 20 year development effort, and a project paper was being written for the follow-on project.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Singapore made a program results audit of the Rapti Zone Rural Area Development Project to review AID's assistance to the HMG/Nepal's development program in the Rapti Zone. The specific audit objectives were to measure the progress and effectiveness of the Project, evaluate USAID/Nepal's management of the Project, and review compliance with AID policies and regulations.

The audit was conducted in Kathmandu and the Rapti Zone headquarters in Tulsipur during July, August, and September of 1986. Audit work included the review of appropriate USAID/Nepal and HMG/Nepal records and files; interviews with USAID/Nepal, HMG/Nepal, and contractor officials; and inspection of Project-funded activities in the Rapti Zone. The audit covered the period from August 12, 1980 through June 30, 1986 and expenditures of \$16.6 million, \$7.0 million in direct AID procurement and \$9.6 million in budget support for HMG/Nepal. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The Rapti Zone Rural Area Development Project has met many of the Project objectives but has not met its principal agricultural production objectives. Nevertheless, the Project has built a solid base for future development activities. USAID/Nepal's management of the Project has been satisfactory. In implementing the Project the Mission has complied with AID policies and regulations.

The Rapti Zone Project area is in one of the most remote and disadvantaged parts in Nepal. The Project has introduced a variety of development activities to the area, and even though some of these activities will not be included in the follow-on project, the Project has helped improve the lives of the people living in the area.

The plans for the Rapti Zone Rural Area Development Project were general and overly optimistic, were not strongly focused on project purposes, and did not provide effective strategies for dealing with the implementation constraints in the remote hill areas. His Majesty's Government of Nepal (HMG/Nepal) has not effectively managed the local currency that was supplied to support Project activities. Analysis of the financial statements of the Rapti Zone Branch of the Agricultural Development Bank (ADB) raised questions concerning the Branch's management. The Project's long-term training requirements have contributed little to strengthening the manpower resources of the Rapti Zone, and an assessment survey of the Rapti Zone roads has not been used.

We recommend that in the follow-on Rapti Zone Project USAID/Nepal make provisions for dealing with the major implementation constraints to increasing agricultural production, including a mechanism for using technology from the USAID/Nepal Agricultural Research and Production Project and other research projects. We recommend training for Project financial staff and revised procedures for handling questioned costs. We recommend a review of the financial and management practices of the Rapti Zone Branch of the Agricultural Development Bank. We recommend that USAID/Nepal limit more of the Project funded long-term training to people who have served in the Rapti Zone or agreed to serve there at the end of the training. Finally, we recommend requesting a refund for the cost of the unused road assessment survey.

A. Findings and Recommendations

1. Poor Project Design Was Caused By Overly Optimistic Assumptions

The AID Handbook required that project papers include well developed plans for implementation. The plans for the Rapti Zone Rural Area Development Project were general and overly optimistic, were not strongly focused on Project purposes, and did not provide effective strategies for dealing with the implementation constraints in the remote hill areas. The overly optimistic project plans were the result of using unwarranted assumptions and failing to take into account the difficulties involved in implementing a complex project in a very remote area. As a result the Project has not met its agricultural production objectives, and implementation has been delayed.

Recommendation No. 1

We recommend that USAID/Nepal include in the project paper for the follow-on Rapti Zone Rural Area Development Project specific plans for dealing with the major constraints to increasing agricultural production, including a mechanism for incorporating into the Project the research results of its Agricultural Research and Production Project, and any other appropriate research projects.

Discussion

AID Handbook 3, Chapter 3, stated that a completed project design is usually a blueprint for transforming a concept into reality, i.e., a successfully implemented project. The Handbook went on to say that the thoroughness with which the blueprint is prepared will determine, in large measure, the speed and ease with which a project can be executed and its success in achieving the stated objectives. The importance of having a well-developed plan for implementing a project was further emphasized in the listing of design tasks that determine how project objectives will be reached i.e., the technology to be employed, the types of actions required, and their scope, locations, and inter-relationships. In setting forth what was intended the Handbook used a hypothetical agricultural production project to show what should be included in the project paper and listed the training of extension workers, minimizing their mobility problems, providing advisory service, and addressing farmer-extension receptivity issues.

Although increasing agricultural production was the Project's principal objective, the project paper did not include detailed plans for meeting the very ambitious production

objectives. Further, the project paper stated that this Project was the first stage of an expected 15 to 20 year involvement by AID in rural development in the Rapti Zone. The description of the activities for implementing this Project, however, did not show how this first stage related to the contemplated 15 to 20 year program. The Final Project Evaluation dated October 31, 1985 reported that the Project was overly complex and disparate, its components remained separated rather than strongly linked to Project purposes. It went on to say that inputs were not focused effectively on key production sectors, and that the Project did not achieve its often-unrealistic target-output production levels in any of its critical areas.

For improved technology the Project was designed to draw on the USAID/Nepal Integrated Cereals Project and a proposed Hill Agricultural Production Systems Project. The project paper was silent, however, on how this technology was to be incorporated into the Project and how possible new crop varieties were to be adapted to conditions in the Rapti Zone, even though it recognized that because the Rapti Zone had very complex ecosystems most technology packages had limited application.

The extension plan was to recruit local men and women, so that there would be at least five farm leaders in each of the 185 villages and at least five Small Farmer Development Program units in each district. Service centers were to be constructed in the districts to provide facilities for extension personnel. Extension efforts in the Rapti Zone however, were far too limited to be effective. Extension staff positions were often not filled, and when filled the incumbents were poorly trained and spent little time in the field working with farmers. As an example, in one district nine of ten positions were reported filled. Of these nine, however, one incumbent was on study leave in India, one had recently received a B.S. degree and was "not willing to work", one had been absent without leave for six months, and two were working at the zone headquarters instead of in the district where they were assigned.

The project paper did not address agricultural inputs directly. It simply noted that an improved delivery system would meet increased local demand for agricultural inputs as well as meeting many other Project requirements. The logical framework included provision of inputs--fertilizer and some seed--from external sources as an important assumption.

The detailed plans for effective implementation that were called for in the Handbook were not included in the project paper principally because of the overly optimistic assumptions. The Rapti Zone Project was not alone in making

overly optimistic design assumptions. The International Center for Integrated Mountain Development (ICIMOD), an organization concerned with development in the Hindu-Kush Himalayas, recently reviewed the evaluations of eight rural development projects in Nepal. They found that all of the projects had underestimated the problems of implementing development projects in the remote areas of Nepal.

The project paper stated that the technology required to meet the agricultural production objectives existed, either in the Rapti Zone or in other parts of Nepal. The Final Project Evaluation reported that one of the principal reasons for the Project's failure to meet its objectives was that the Project design overestimated the availability of improved technologies readily acceptable to farmers. The assumption that existing research technologies would be sufficient ignored both the complexity of the Zone's farming systems and the constraints affecting farmer decisions concerning technology. Technologies were developed and proven successful, where inputs were available, for certain farming systems/agro-ecosystems. For many areas, however, acceptable technologies had not been developed. AID, the HMG/Nepal's Ministry of Agriculture, and contractor officials confirmed that at the time of the audit much of the technology needed for increased production in the hills was still not available. Most of the results of the Integrated Cereals Project were not applicable to the hills and the proposed hillside project was never implemented.

The project paper assumed that the Ministry of Agriculture would provide the required extension staff and that, after project-funded training, this staff would instruct the farmers in the new farming procedures. The planned extension program was not, however, supported to the degree necessary and planned for in the Project design. The extension manpower was increased over the life of the project, but it was still too limited in number and in the quality of the staff's preparation.

Agricultural inputs were to be made available as needed, but the organization for distribution was not capable of providing good seeds and minimal amounts of fertilizer to the hill areas. One serious problem in supplying these inputs was the lack of roads. The Project design included construction of 200 kilometers of roads over which light trucks could travel in the six to eight dry months of the year. These roads would have provided only limited access to an area of about 4,000 square miles, but their completion would have greatly increased the Rapti Zone's transportation infrastructure. The Project budgeted \$3.5 million for the roads and the Final Project Evaluation reported that the funds were used well but were insufficient to complete the

planned roads. A recent road assessment found that construction of the Project's 200 kilometers of roads would cost at least \$25 million.

The result of the overly optimistic Project plans was the failure to meet Project objectives. The Final Project Evaluation found no indication that agricultural production increased to anywhere near the 27 percent called for in the project paper. Noting that reliable agricultural production data was not available from any source, nationally compiled statistics were used to estimate Rapti Zone production. Also progress during the first two years of implementation was very slow. The project paper had not taken into account the serious difficulties that would be encountered in organizing and staffing a project requiring the involvement and cooperation of many different host country organizations. This delay made parts of the first project evaluation, which was not rescheduled to reflect the delay, largely irrelevant.

Designing a project for an area that needs so much and has such a limited capacity to absorb assistance is very difficult. Implementing that project in a remote part of Nepal that is four-fifths the size of the State of Connecticut and has only 65 miles of all-weather roads is even more difficult. The designers of the Rapti Zone Rural Area Development Project did not sufficiently consider these constraints and thus made optimistic assumptions that resulted in limited success for the Project. The Rapti Zone Area Development Project probably would have been considered more successful if it had been evaluated against a standard that more nearly reflected what was possible. The follow-on project should realistically assess the constraints that face implementation in the Rapti Zone and include workable strategies for overcoming these constraints as well as more modest targets.

Management Comments

USAID/Nepal concurred with the recommendation in this finding.

2. Project Local Currency Funds Should Be Better Managed

USAID/Nepal has provided \$9.6 million in local currency to support Project activities. The grant agreement required the HMG/Nepal to manage the Project effectively. The Project local currency has not been well managed, principally because the HMG/Nepal has been unable to assign to the Project the trained people needed for effective management. Also, communication between the HMG/Nepal field organizations has been weak; the District Treasury Offices (DTO) have not been advising the Project Coordinator's Office (PCO) when they questioned costs. As a result, the release of Project funds was delayed, and questioned costs were reimbursed by USAID/Nepal.

Recommendation No. 2

We recommend that USAID/Nepal include in the follow-on Rapti Zone Rural Area Development Project the training in appropriate accounting procedures and regulations for Project financial staff required to manage the Project local currency funds effectively.

Recommendation No. 3

We recommend that USAID/Nepal request His Majesty's Government of Nepal's District Treasury Offices to inform the Project Coordinator's Office of all questioned Project costs and advise USAID/Nepal of action taken to resolve the questioned costs.

Discussion

USAID/Nepal has provided \$9.6 million in Nepalese Rupees to finance Project activities. The funds have been used for Project salaries, supplies, office equipment, maintenance, construction, training, and travel. Project budgets are prepared annually. Funds for budgeted expenditures are then advanced by USAID/Nepal to the HMG/Nepal's Controller General, who, in turn, releases the funds to the line agencies through the District Treasury Offices (DTO) in the Rapti Zone.

Section B.2(b) of the grant agreement's standard provisions specified that the HMG/Nepal was to provide qualified and experienced management for the Project. The HMG/Nepal should have provided better training for its accounting staff to help ensure effective financial management of the Project.

The HMG/Nepal has not provided the financial management staff needed to administer the large AID-financed local currency program. Advances have remained outstanding for long

periods, and expenditure reports have been filed late. These reports should have been submitted within one year, but 32 of the 49 reports reviewed were submitted 13 to 46 months after the expenditures were incurred.

The HMG/Nepal has had difficulty filling Project positions because people do not want to work in the remote Rapti Zone where living conditions are hard. During the audit it was observed that personnel in the Dang District Irrigation Agency were not familiar with many of the Project accounting records, and personnel at the Dang District Soil Conservation and Livestock offices were not familiar with some of the HMG/Nepal fiscal regulations. DTO auditors observed that at some of the district line agency offices the accountants had limited knowledge of the HMG/Nepal fiscal regulations. Also, communication between the PCO and the DTOs, the offices responsible for reviewing Project costs, was weak.

Having people with insufficient training accounting for Project funds has delayed Project implementation. Funds were advanced by trimester, and when these advances were not properly accounted for the HMG/Nepal's Controller General delayed release of additional funds. In NFY 1985/86* 83 percent of the Project funds were released either (1) after the end of the trimester for which they were to be used, (2) too close to the end of the fiscal year to be used effectively, or (3) not at all. According to the Controller General, the main reason for the slow release of funds was the outstanding advances held by the line agencies.

During the last three years, the Dang DTO has questioned expenditures of \$650,000** claimed by 11 Dang District line agencies. Many of the irregularities were caused by the line agency accountants not submitting proper supporting documents, exceeding budget line items, or not having required approvals. Because of poor communications, the DTO has not advised the PCO when costs have been questioned. As a result the PCO submits reimbursement vouchers to USAID/Nepal

* Nepal does not use the Gregorian calendar; for example, its fiscal year 2042/43 ends on July 15, 1986. For convenience the Nepalese Fiscal Years (NFY) will be converted to comparable Gregorian calendar dates.

** These transactions were made in Nepalese Rupees. Here and in the rest of the report, monetary amounts will be shown in U.S. dollars. The conversion rate used is \$1.00 = 21.30 Nepalese Rupees.

that include costs that have been questioned by the DTO, and although unaware of these questioned costs, USAID/Nepal has approved their payment. Further, the HMG/Nepal rarely advised USAID/Nepal when questioned costs were resolved.

Financial management must be improved so that Project funds can be released to meet Project needs. The key to improving fund management is training for Project personnel and oversight by the line agencies central offices. In addition, the DTO must advise the PCO when costs are questioned, and USAID/Nepal must be advised when the questioned costs are resolved.

Management Comments

USAID/Nepal concurred with Recommendation No. 2 to this finding.

With regard to the Recommendation No. 3, USAID/Nepal replied that they did not reimburse questioned costs as stated in the draft report. They said that reimbursed expenditures under the Project contained certain costs which, after the fact, became questionable as a result of an internal USAID/Nepal financial review. They had no knowledge when costs were "questioned" by any agency of His Majesty's Government of Nepal, including the District Treasury Offices, prior to certification of payments. Further, USAID/Nepal noted that the recommendation as stated, would not improve the flow of funds and the proper accounting for and use of funds in the districts.

Office of the Inspector General's Comments

Regarding Recommendation No. 3, USAID/Nepal indicated in their cable of December 15, 1986 they were unable to make withholdings against reimbursement claims because they had no knowledge of costs that were questioned by agencies of His Majesty's Government of Nepal including the District Treasury Offices. We concur with this comment and the report has been revised to clarify this point.

To account for the use of AID funds and to preclude USAID/Nepal from honoring reimbursements claims for costs questioned by the District Treasury Offices of His Majesty's Government of Nepal is precisely why we believe implementation of Recommendation No. 3 is essential.

In our opinion, the Mission's other comments are neither responsive to Recommendation No. 3 nor do they address the problems discussed in the draft report.

3. The Management Of The Agricultural Credit Program In The Rapti Zone Was Questioned

As part of the Rapti Zone Rural Area Development Project's agricultural credit program, USAID/Nepal provided \$920,000 to the Agricultural Development Bank (ADB) for making loans to small farmers and cooperatives in the Rapti Zone. The grant agreement required the HMG/Nepal to ensure that the Project was conducted using sound financial and management practices. A review of the financial statements of the Rapti Zone Branch of the ADB showed that it had a negative current ratio, and its expenses as a percentage of income were on the rise. This poor performance was caused by increases in both delinquencies and interest expenses. If these problems are not corrected it may not be possible to continue the credit program in the Rapti Zone.

Recommendation No. 4

We recommend that USAID/Nepal, in coordination with the Agricultural Development Bank, review the current financial and management practices of the Bank's Branch Office in the Rapti Zone and evaluate its capability for sustaining the credit program.

Discussion

USAID/Nepal provided \$920,000 to the ADB to make loans to farmers and cooperatives in the Rapti Zone. Section B.2 of the grant agreement's standard provisions required the HMG/Nepal to carry out the Project using sound financial and management practices.

The HMG/Nepal has not met these requirements. The ADB's Rapti Zone Branch Office's financial statements reflected a negative current ratio and an increase in total expenses as a percentage of total income. The current ratio, the relationship between current assets and current liabilities, was 1 to 2.4, i.e., for every rupee of current assets it had 2.4 rupees of current liabilities. This indicates that the Branch may not have sufficient cash or liquid assets to meet its current liabilities. Delinquent payments also increased substantially. In NFY 1980/81 delinquent payments amounted to \$145,500, and by NFY 1985/86 they had increased to \$670,000.

The principal cause for the deteriorating financial condition has been expenses, over the last three years, increasing more rapidly than total income, mainly because during this time interest expense rose from \$18,000 to \$85,000. This increase was attributed to loans from the Nepal Rastra Bank and coupons issued to the Agricultural Input Corporation.

Liabilities to these organizations have risen in three years from \$366,000 to \$869,000. ADB personnel attributed the increase in delinquent payments to the remote areas in which the Branch operates and the difficulties in contacting lenders.

The weak management of the Branch has eroded its resources. Continuation of the credit program in the Rapti Zone depends, to some degree, upon the strength of the Branch Office. Failure to improve the financial strength of the Branch could result in curtailing the Rapti Zone credit program.

The weak financial position of the Branch Office of the ADB in the Rapti Zone indicates that possibly the Branch has not been managed effectively. USAID/Nepal should review the Office's management practices and procedures to evaluate its capability to sustain the credit program.

Management Comments

USAID/Nepal agreed to make a study of the Branch Office to determine whether operating procedures are adequate to sustain the credit program in the Rapti Zone.

4. Long-Term Training Contributed Little To Development In The Rapti Zone

The long-term training objectives of the Project are to increase the technical and management skills in the Rapti Zone and to reward people for serving there. Most of the people selected for long-term training neither served in the Rapti Zone prior to training nor were assigned there on completion of training. The Project training plans did not include provisions for using Project funded training to build institutions in the Rapti Zone. As a result, the \$415,000 spent for long-term training has added little to the development skills in the Rapti Zone.

Recommendation No. 5

We recommend that USAID/Nepal include a provision in the grant agreement for the new Rapti Zone Rural Area Development Project limiting long-term training under the Project to those who have served at least a year in the Rapti Zone or who have signed an agreement to serve in the Rapti Zone when the training is completed.

Discussion

In the project paper, the training component of the Project was described as having two objectives. First, people were to be trained under the project to increase the technical and management skills that can be used to serve the Rapti Zone. Second, the scholarship program was intended to assist HMG/Nepal develop and retain people assigned to the Project area, in effect to reward senior technical and administrative personnel for service in the Rapti Zone.

Most of the Project funded long-term training has not contributed to the technical and management skills in the Rapti Zone, or to motivating people with those skills to work there. As of June 30, 1986, 18 people had begun Project funded long-term training programs. The cost of these programs was approximately \$415,000. Of the 18, eight were selected from posts in Kathmandu or other parts of Nepal. Seven of the 18 have completed their courses, five of whom had been selected from Kathmandu and two from the Rapti Zone. The five from Kathmandu all returned to jobs in Kathmandu; one of those selected from the Rapti Zone returned to work there and the other returned to a job in Kathmandu.

The Project also used U.S. owned excess P.L. 480 Indian rupees to finance long-term training in India. Twenty-four people were selected for this training, but only four were selected from positions in the Rapti Zone. Four people have

completed training in India, none of whom were selected from the Rapti Zone or were assigned there when their training was completed.

The Project training plans did not include provisions for using Project funded training to build institutions in the Rapti Zone. HMG/Nepal officials nominated people for Project funded long-term training even though they had no plans for those people to serve in the Rapti Zone. They considered anybody in a job related to rural development an appropriate candidate for Project funded training.

After the expenditure of \$415,000 for long-term training the Project has had little impact on increasing the trained manpower serving the Rapti Zone. Long-term training, potentially a key element in the Project's important objective of institution building, has done very little for the institutions of the Rapti Zone. The second objective of rewarding people for service in the Rapti Zone was only partially met because 28 of the 42 people selected for long-term training had not served in the Rapti Zone.

Most of the long-term Project funded training has contributed little to strengthening the manpower resources of the Rapti Zone. Future training should be limited to people having direct association with development work in the Rapti Zone. Project funded training should be used to promote people within the area, not out of the area. With careful planning, more Project trained people could be employed in the Rapti Zone.

Management Comments

USAID/Nepal concurred with the recommendation in this finding.

5. An AID-Financed Road Assessment Survey Has Not Been Used

USAID/Nepal paid \$642,000 for a road assessment survey that has not been used. The grant agreement requires the HMG/Nepal to use resources provided under the grant to further the objectives of the Project. The HMG/Nepal has not actively sought donor assistance for constructing the roads. If the roads are not constructed, the funds for the study will not have been used to further Project objectives, and many development activities in the Rapti Zone will be delayed.

Recommendation No. 6

We recommend that USAID/Nepal seek a refund from His Majesty's Government of Nepal for the cost of the survey, as provided under Section D.2 (a) of the grant agreement standard provisions, if His Majesty's Government of Nepal has no firm plans to use the assessment survey.

Discussion

The grant agreement for the Rapti Zone Rural Area Development Project provided \$3.5 million to improve 200 kilometers of roads to accommodate five to seven ton, single-axle trucks for at least eight months of the year. According to USAID/Nepal Project personnel, that amount was only a fraction of the amount required to upgrade the roads. The \$3.5 million were used effectively but were sufficient to improve only a portion of the Project roads.

USAID/Nepal, in conjunction with the HMG/Nepal, engaged Louis Berger International Inc. to make an assessment of the technical requirements and an estimate of the costs and benefits that would accrue by improving 200 kilometers of hill roads in the Rapti Zone. Although this assessment was completed in April, 1986, at a cost of \$642,000, the HMG/Nepal had no plans for constructing the roads covered by the assessment.

Section B.3 of the grant agreement's standard provisions states that resources financed under the grant will be used to further the objectives of the Project. If the resources or services are not used in accordance with the grant agreement, Section D.2 (a) of the standard provisions states that USAID/Nepal may require the HMG/Nepal to refund to AID the cost of those services in U.S. dollars.

Prior to executing the contract for the assessment, USAID/Nepal was advised by the Asian Development Bank that the Bank would consider the Rapti Zone roads for a future project. The HMG/Nepal however, has neither actively sought assistance from the Asian Development Bank or other donors

for the construction of the roads nor formulated other plans for constructing the roads.

If the roads included in the road assessment survey are not constructed the funds used to finance the assessment will not have contributed to meeting the Project objectives. Further, failure to construct the roads will delay development activities in the Rapti Zone.

USAID/Nepal provided funds for an assessment study costing \$642,000 that, at present, the HMG/Nepal has no plans to utilize. USAID/Nepal should ask the HMG/Nepal to make effective use of the study and if the HMG/Nepal does not propose an effective use of the study, USAID/Nepal should seek a refund from the HMG/Nepal for the cost of the study.

Management Comments:

USAID/Nepal agreed that the assessment should be used but did not agree that they should request a refund for the cost of the assessment if it is not used. They explained that there was no AID requirement that the assessment should be used.

Office of the Inspector General

We believe the possibility of a refund should be used as a means to ensure that the HMG/Nepal makes proper use of the AID resources spent on the assessment.

B. Compliance and Internal Control

Compliance

Compliance with AID standards and the project agreement was adequate. USAID/Nepal however, should ensure adherence to the AID Handbook, grant agreement provisions, and project paper objectives. For example, Finding 1 illustrates a need to comply with AID project design guidelines. Findings 2, 3, and 5 indicate that the HMG/Nepal should adhere to grant agreement provisions on project management and on the use of project resources. Finding 4 shows that USAID/Nepal should ensure that participant training is better used to accomplish project objectives. Also, the HMG/Nepal was not complying with the grant agreement requirement for contributions to the Project. Nothing was found during the course of the audit to indicate that items not included in the audit tests were not in compliance with applicable laws and regulations.

Internal Control

Tests of internal controls indicated an acceptable level of compliance, with the exception of weaknesses noted in Finding 2 concerning the management of local currency and in the approval procedures for the technical assistance contract covered in Other Pertinent Matters.

C. Other Pertinent Matters

1. Some Of The Services Provided Under The Technical Assistance Contract Were Not Consistent With The Contract Objectives

The Planning and Development Collaborative International (PADCO) contract for technical assistance was amended, as a matter of convenience, in order to recruit a consultant. USAID/Nepal wanted the services of a specific individual. After failing to engage that individual on a personal services contract, USAID/Nepal decided to engage him through the PADCO contract under the Rapti Zone Rural Area Development Project. The contract's objective was to provide on-site, technical assistance to the Project Coordinator's Office located in the Rapti Zone, several hundred miles west of Kathmandu. The consultant, however, works primarily in Kathmandu, reports to the Office of the USAID/Nepal Director, and serves as liaison between USAID/Nepal and the HMG/Nepal's National Planning Commission, Ministry of Works and Transport, and Ministry of Panchayat and Local Development. The services of the consultant were not consistent with the contract objectives and contributed little to meeting those objectives.

Funding for the consultant's services was provided from AID's Regional/Housing and Urban Development Office in Bangkok and from reobligated funds. The cost of these services to date was \$242,000 and will be approximately \$345,000 when the consultant's services are completed. The cost is reported on the same voucher as the costs of the other PADCO consultants. The voucher is administratively approved by the Rapti Zone Rural Area Development Project Officer in spite of the fact that the consultant does not report to the Project Officer. Having a project officer who is not responsible for the consultant's services approve those services for payment weakens USAID/Nepal's financial internal controls.

Management Comments

In reply to the draft report, USAID/Nepal stated that much of the consultant's time and work involves regional planning issues that do not relate to the Rapti Project. Nevertheless, the Consultant has made, and continues to make, a significant, specific contribution to the Rapti Project. Outside of his work on Rapti he has been instrumental in stimulating other donor interest and funding sources for urban/regional activities.

Office of The Inspector General Comments

The Office of The Inspector General does not question the value of the consultant's contribution to USAID/Nepal's economic assistance efforts in Nepal. Greater control, however, should be exercised over contract funds to ensure that the funds are used to accomplish contract objectives.

2. USAID/Nepal's Monitoring Of Host Country Contributions Should Be Improved

According to the grant agreement, the HMG/Nepal was to contribute \$7 million to the Project. The contributions were to be made over the five-year life of the Project, NFY 1980-85. USAID/Nepal estimated that the host country contribution to the Project was far short of the amount originally planned. The USAID/Nepal Project Workplan and Proposed Budget for NFY 1986/87 dated July 22, 1986 reported that as of the end of NFY 1984/85, the HMG/Nepal contribution amounted to \$2.8 million instead of the planned \$7 million. The contribution was calculated using an exchange rate of NRs 11.9 equals \$1.00, the rate that was in effect at the beginning of the Project. The current exchange rate is NRs 21.3 equals \$1.00. Using that rate would substantially reduce the dollar equivalent of the host country contribution.

HMG/Nepal has not met its planned contribution for the project. USAID/Nepal should include in the follow-on project improved means of monitoring host country contributions and provisions for corrective action if contributions fall short of what was planned.

AUDIT OF
RAPTI ZONE RURAL AREA DEVELOPMENT
PROJECT IN NEPAL
PROJECT NO. 367-0129

PART III - APPENDICES

(4) ACTION AID2 INFO CHG DCM

VZCZCGPJ102
 PP RUEHGP
 DE RUFHKT #9551 3490943
 ZNR UUUUU ZZH
 P 150945Z DEC 96
 FM AMEMBASSY KATHMANDU
 TO AMEMBASSY SINGAPORE PRIORITY 0557
 BT
 UNCLAS KATHMANDU 009561

LOC: 59 179
 15 DEC 96 0943
 CN: 17297
 CTRG: AID
 DIST: AID

ADM AID

FOR DONALD RYDER, RIG/A/S

E.O. 12355: N/A

SUBJECT: USAID/N COMMENTS ON RAPTI ZONE RURAL AREA
 DEVELOPMENT PROJECT AUDIT REPORT.

REF: OM RYDER TO WILSON DTD NOV.26,1996

1. GENERAL COMMENTS:

- A. IN GENERAL THE FINDINGS AND RECOMMENDATIONS ARE
 CONSISTENT WITH THE FINDINGS AND RECOMMENDATIONS OF THE
 1995 EVALUATION AND THE FINANCIAL ANALYSIS PREPARED FOR
 THE NEW RAPTI DEVELOPMENT PROJECT.

- B. MOST OF THE RECOMMENDATIONS HAVE ALREADY BEEN
 INCORPORATED IN THE DRAFT PROJECT PAPER FOR THE NEW
 RAPTI DEVELOPMENT PROJECT.

2. SPECIFIC COMMENTS:

- A. RE: RECOMMENDATION NO.3, PP 14-17 OF DRAFT
 REPORT. USAID/N DID NOT REIMBURSE QUESTIONED COSTS AS
 STATED HERE. REIMBURSED EXPENDITURES UNDER THE PROJECT
 CONTAINED CERTAIN COSTS WHICH, AFTER THE FACT, BECAME
 QUESTIONABLE AS A RESULT OF AN INTERNAL USAID/N
 FINANCIAL REVIEW. USAID HAD NO KNOWLEDGE THAT ANY
 COSTS WERE "QUESTIONED" BY A GON ENTITY INCLUDING DTO
 PRIOR TO CERTIFICATION OF PAYMENTS.

- WE BELIEVE THE RECOMMENDATION IN ITS PRESENT FORM WILL
 NOT IMPROVE THE FLOW OF FUNDS AND THE PROPER ACCOUNTING
 FOR AND USE OF FUNDS IN THE DISTRICTS. SINCE THE GON
 HAS ITS OWN INTERNAL ACCOUNTING PROCEDURES WHICH ARE IN
 FACT BEING IMPROVED UNDER THE PROJECT, USAID IS NOT
 PRIVY TO ROUTINE INTERNAL INQUIRIES OF GON ENTITIES.
 USAID REALLY HAS NO AUTHORITY TO REQUEST THE DISTRICT
 TREASURY OFFICES TO TAKE ACTIONS AS SUGGESTED.

- B. AS STATED ON P.3 REVISED PROCEDURES FOR HANDLING
 QUESTIONED COSTS ARE NOT STIPULATED.

- C. RE: RECOMMENDATION NO.5

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RIG/A/S

USAID/NEPAL DOES NOT AGREE WITH THE FINDINGS OR RECOMMENDATION THAT AID SHOULD SEEK A REFUND FROM THE HMG/NEPAL FOR THE COST OF THE SURVEY FOR THE FOLLOWING REASONS:

1. HMG/NEPAL IS IN FACT CURRENTLY USING THE ASSESSMENT SURVEY IN MAINTENANCE AND CONSTRUCTION WORK UNDERTAKEN DURING THIS NEPALI FISCAL YEAR. THE DCM FROM THE EMBASSY, THE USAID/NEPAL DIRECTOR AND THE PROJECT OFFICER DURING A RECENT JOINT FIELD TRIP HAVE PERSONALLY OBSERVED THAT THE SURVEY IS BEING USED.
2. HMG/NEPAL HAS RECENTLY REQUESTED THE ASIAN DEVELOPMENT BANK TO INCLUDE THE RAPTI ROADS AS PART OF THEIR PROGRAM FOR THE NEXT YEAR. WHILE CONTINUING TO ENCOURAGE THE HMG/N TO REQUEST OTHER DONOR ASSISTANCE USAID/NEPAL IS SATISFIED THAT ACTION IS BEING TAKEN TO USE THE ASSESSMENT SURVEY.
3. IT IS STANDARD PRACTICE FOR USAID TO FUND SIMILAR FEASIBILITY STUDIES LIKE THE ASSESSMENT SURVEY OF THE RAPTI ROADS TO ESTABLISH WHETHER OR NOT CONSTRUCTION WORK SHOULD BE UNDERTAKEN. THIS STUDY HAD NOT BEEN CONDUCTED DURING PROJECT DESIGN OR IN THE INITIAL PHASE OF CONSTRUCTION WORK; THUS USAID/NEPAL AGREED WHEN REQUESTED BY THE GOV, TO CONDUCT THE STUDY. USAID/NEPAL RECOGNIZES THE VALIDITY OF THIS STUDY AS A BASIS FOR FUTURE CONSTRUCTION WORK. MISSION BELIEVES THAT THE USE OF PROJECT RESOURCES FOR THIS PURPOSE WAS PROPER AND THAT A REQUEST FOR A REFUND FOR THE COST OF THIS ASSESSMENT SURVEY WOULD NOT BE A REASONABLE REQUEST.

IN VIEW OF THE ABOVE, WE BELIEVE RECOMMENDATION NO. 3 SHOULD BE OMITTED FROM THE REPORT.

WEIL
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#9561

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LIST OF REPORT RECOMMENDATIONS

Recommendation No. 1

We recommend that USAID/Nepal include in the project paper for the follow-on Rapti Zone Rural Area Development Project specific plans for dealing with the major constraints to increasing agricultural production, including a mechanism for incorporating into the Project the research results of its Agricultural Research and Production Project, and any other appropriate research projects.

Recommendation No. 2

We recommend that USAID/Nepal include in the follow-on Rapti Zone Rural Area Development Project the training in appropriate accounting procedures and regulations for Project financial staff required to manage the Project local currency funds effectively.

Recommendation No. 3

We recommend that USAID/Nepal request His Majesty's Government of Nepal's District Treasury Offices to inform the Project Coordinator's Office of all questioned Project costs and advise USAID/Nepal of action taken to resolve the questioned costs.

Recommendation No. 4

We recommend that USAID/Nepal, in coordination with the Agricultural Development Bank, review the current financial and management practices of the Bank's Branch Office in the Rapti Zone and evaluate its capability for sustaining the credit program.

Recommendation No. 5

We recommend that USAID/Nepal include a provision in the grant agreement for the new Rapti Zone Rural Area Development Project limiting long-term training under the Project to those who have served at least a year in the Rapti Zone or who have signed an agreement to serve in the Rapti Zone when the training is completed.

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Recommendation No. 6

We recommend that USAID/Nepal seek a refund from His Majesty's Government of Nepal for the cost of the survey, as provided under Section D.2 (a) of the grant agreement standard provisions, if His Majesty's Government of Nepal has no firm plans to use the assessment survey.

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APPENDIX 3

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