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AUDIT OF USAID/HONDURAS'
SMALL FARMER TITLING PROJECT NO. 522-0173

Audit Report No. 1-522-87-16
February 20, 1987

AGENCY FOR INTERNATIONAL DEVELOPMENT

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February 20, 1987

MEMORANDUM

TO : Mr. John Sanbrailo, Director, USAID/Honduras

FROM : RIG/A/T, *Conrad N. Gothard, Jr.*

SUBJECT: Audit Report No. 1-522-87-16, "Audit of USAID/Honduras' Small Farmer Titling Project No. 522-0173"

This report presents the results of audit of USAID/Honduras' Small Farmer Titling project No. 522-0173.

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results audit of USAID/Honduras' Small Farmer Titling project. Our audit objectives were to determine whether: (1) desired results had been achieved, (2) project activities were suitably funded, (3) project implementing agencies were managing and utilizing AID resources economically and efficiently, and (4) internal controls were adequate.

The audit disclosed that the titling activities had suffered serious implementation problems and delays. The funding mechanism for delineation and mapping activities had not always met the needs of the implementing agency. Vehicles purchased under the project were not being used efficiently and internal controls did not provide reasonable protection against waste or misuse of resources.

The audit findings indicate: the project had not attained an acceptable level of performance in meeting its objectives; the operation of the Fixed Amount Reimbursement system had not always assured funding for delineation activities; the National Agrarian Institute (INA) was ineffective in collecting money owed for titled lands; and vehicles purchased for the exclusive use of the project were not being used efficiently and some had been diverted to other uses.

Our recommendations seek to correct the deficiencies encountered during the course of our review. We have recommended that USAID/Honduras: obtain from responsible Government of Honduras officials a revised implementation plan for the remainder of the project; explore ways to ensure that delineation and mapping activities are provided steady

funding; obtain evidence that INA has taken steps to improve collection efforts and determine the possibility of programming funds generated by the project or depositing them in an interest-bearing account; and obtain evidence that INA has established and implemented effective procedures to ensure that vehicles are properly maintained and used for program activities.

The Mission agreed with recommendations Nos. 1, 3 and 4 but suggested some changes which have been made in the report. Recommendation No. 2 is closed upon issuance of the report. Mission comments are summarized in the report and the full text is included as Appendix No. 1.

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

EXECUTIVE SUMMARY

USAID/Honduras' Small Farmer Titling project was to establish a functioning, coordinated system for titling rural lands in Honduras, increase the administrative capacity of National Agrarian Institute to issue up to 50 titles per day (70,000 titles by the end of the project) in six departments of Honduras, and to begin work in a seventh department within five years using an interinstitutional approach. The Project Agreement was signed on August 12, 1982 and provided funding of \$16.7 million, of which \$10 million was an AID loan, \$2.5 million a grant, and \$4.2 million a Government of Honduras counterpart contribution. The project was to be completed by August 29, 1987.

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results audit of the project. Our audit objectives were to determine whether: desired results had been achieved, project activities were suitably funded, the project implementing agency was managing and utilizing AID resources economically and efficiently, and internal controls were adequate.

The audit disclosed that the titling activities had suffered serious implementation problems and delays. The operation of the fixed amount reimbursement system for delineation and mapping activities had not always met the needs of the implementing agency. Vehicles purchased under the project were not being used efficiently and internal controls did not provide reasonable protection against waste or misuse of these resources.

Although the titling process was behind schedule, the Mission stated that an interinstitutional mechanism to provide land titles to small farmers had been fully developed and was in operation, producing more titles (over 20,000 in four years) than ever before in Honduras and collecting valuable information on the rural sector. For instance, during the period 1975-81, INA had issued only 246 provisional titles to peasant groups and only 17 to individuals. For the first time in the history of Honduras, the National Agrarian Institute and Cadastral Executive Directorate were compiling a solid data base of statistics on the nation's rural population. AID officials involved in the project were aware of many of the problems detected during audit and had taken corrective actions.

The audit findings indicated: the project had not attained an acceptable level of performance in meeting its objectives; the operation of the Fixed Amount Reimbursement system had not always responded to the needs of the project; the National Agrarian Institute had not been effective in collecting money owed for titled lands; vehicles purchased for the exclusive use of the project were not being used efficiently and some had been diverted to other uses.

The project had successfully established a mechanism for adjudicating land titles, but the actual number of titles conferred lagged behind the original project goal. The original goal was to issue about 70,000 land titles to benefit an equal number of farm families during a five-year period. Because it was later found that the goal substantially exceeded the number of eligible farms, USAID/Honduras has amended the project agreement, reducing the number of titles from 70,000 to 40,000. As of July 31, 1986, only 20,430 titles had been delivered. This shortfall occurred because of political problems associated with titling activities and ineffective coordination between the implementing agencies. Unless long-standing implementation problems are effectively addressed, even the revised project objectives may not be reached. We recommended that USAID/Honduras obtain from responsible Honduran officials a revised implementation plan for the remainder of the project. The Mission agreed and suggested wording changes which have been incorporated in the report.

The "front end" of the titling project consists of property delineation and mapping conducted by Cadastral Executive Directorate field brigades. The Directorate had been funding the brigades for some time now from its own budget because of the time required for it to be reimbursed for completed work by the National Agrarian Institute. Fieldwork had been halted four times because the Directorate ran out of money to keep its brigades working. This not only delayed project benefits but also caused trained personnel to leave in search of other employment. We recommended that the Mission, in consultation with the implementing agencies, devise procedures to ensure that delineation and mapping activities are provided steady funding. The Mission maintained that additions to the revolving fund will solve funding problems. The recommendation is closed upon issuance of this report.

The project agreement provided that title recipients were to pay a fair purchase price which would help fund continued titling efforts. However, poverty, logistical problems and an ineffective collection campaign led to a 95 percent delinquency rate. Furthermore, the amount that had been collected was neither being used for the project nor earning interest. Lack of such funds could hamper further titling activities. We recommended that USAID/Honduras obtain evidence that the National Agrarian Institute has taken steps to improve collection efforts and determine the possibility of programming funds generated by the project or depositing them in an interest-bearing account. The Mission basically agreed but suggested exploring the cost-effectiveness of a more vigorous collection policy.

The project provided 35 vehicles which were to be maintained by the National Agrarian Institute and used for project activities. Due to a need for repairs or diversion to other uses, about a third of the vehicles were not available during the period sampled. The Institute's inadequate controls in this area were illustrated by incomplete vehicle maintenance and use records. The lack of an effective maintenance program and the diversion of vehicles to unauthorized uses impeded the project from using AID-provided resources to meet planned objectives. We recommended that the Mission obtain evidence that the National Agrarian Institute has established and implemented effective procedures to ensure that vehicles are properly maintained and used for program activities, and the four vehicles assigned to the Bajo Aguan Valley have been returned to the project. The Mission requested return of the vehicles.

Office of the Inspector General

AUDIT OF USAID/HONDURAS'
SMALL FARMER TITLING PROJECT NO. 522-0173

TABLE OF CONTENTS

	<u>Page</u>
PART I - INTRODUCTION	1
A. Background	1
B. Audit Objectives and Scope	2
PART II - RESULTS OF AUDIT	3
A. Findings and Recommendations	4
1. The Project Was Delayed in Meeting Its Titling Objectives	4
2. The Funding Mechanism for Delineation and Mapping Activities Did Always Meet Project Needs	7
3. Little Agrarian Debt Was Being Collected	11
4. Vehicle Use and Maintenance Practices Sidelined Project Resources	13
B. Compliance and Internal Controls	15
PART III - APPENDICES	
1. Mission Comments	
2. List of Recommendations	
3. Distribution List	

AUDIT OF
SMALL FARMER TITLING PROJECT NO. 522-0173
USAID/HONDURAS

PART I - INTRODUCTION

A. Background

As is the case in most Latin American countries, Honduras' current structure of landholding originated with the social, agricultural and economic organization established during the colonial era. Historically, a clear distinction has always existed between land ownership and its use. A modest effort to redistribute farmland in Honduras began in 1951. The first land reform law, enacted in 1962, also created the National Agrarian Institute (INA) charged with implementing the reform. Subsequent to INA's creation, several decrees were passed by the Government of Honduras (GOH) to adjudicate new lands. However by 1981 the process was virtually stalled because INA had adopted an internal operating policy of providing land only to those groups it could provide services to directly.

The most recent Decree, No. 78 of September 1981, described the means by which full title to coffee farms was to be granted to those Honduran citizens who possessed and occupied such lands, be they government-owned, communal or private. Prior to 1982 the agrarian reform had focussed on community farms. In 1982 the newly elected administration added impetus to land adjudication efforts by making it possible for individuals to obtain titles to their land. The GOH planned to issue 100,000 titles during the period 1982-1986.

The goal of the Small Farmer Titling project was to increase food production, employment, and incomes in rural Honduras by extending the benefits of private property ownership to small farmers. The purpose was to establish a functioning, coordinated system for titling rural lands in Honduras, increase the administrative capacity of INA to issue up to 50 titles per day (70,000 titles by the end of the project, subsequently reduced to 40,000) in six departments of Honduras, and to begin work in a seventh department within the next five years. An interinstitutional approach involving INA and the Cadastral Executive Directorate (DEC, the land survey agency) was adopted to accomplish project objectives.

The Project Agreement was signed on August 30, 1982 and provided funding of \$16.7 million, of which \$10 million was an AID loan, \$2.5 million a grant, and \$4.2 million a GOH counterpart contribution. The project was to be completed within five years, by August 29, 1987. As of July 31, 1986 over \$4 million (24 percent of planned AID funding) had been expended. GOH counterpart contributions as of June 30, 1986 amounted to almost \$3 million.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results audit of USAID/Honduras' Small Farmer Titling project. The audit covered activities from August 30, 1982 through September 19, 1986, including \$8.3 million in AID obligations and \$4.3 million in disbursements as of July 31, 1986. A rotating fund of \$1 million in equivalent local currency was established from Economic Support Funds (ESF) in October 1985 for delineation and mapping activities. However, we did not consider it to be within the \$4.3 million expended because INA had not certified the work nor liquidated the advance to AID. Audit field work was conducted from July 23 to September 19, 1986 (audit work was interrupted for almost three weeks due to a strike at INA). Our audit objectives were to determine whether: (1) desired results had been achieved, (2) project activities were suitably funded, (3) the project implementing agency (INA) was managing and utilizing AID resources economically and efficiently, and (4) internal controls were adequate.

To accomplish these objectives we reviewed project files at USAID/Honduras, INA and DEC; interviewed officials involved in the project and confirmed their observations as appropriate; and tested only internal accounting controls at INA and DEC by tracing several transactions related to implementation activities. The nature of the project, providing titles to Honduran citizens living in rural areas, meant that beneficiaries lived far from towns and often lacked access roads. Field visits were therefore limited to 20 randomly selected title recipients. The audit was performed in accordance with generally accepted government auditing standards.

AUDIT OF
SMALL FARMER TITLING PROJECT NO. 522-0173
USAID/HONDURAS

PART II - RESULTS OF AUDIT

The audit disclosed that the titling activities had suffered serious implementation problems and delays. The operation of the fixed amount reimbursement system for delineation and mapping activities had not always met the needs of the implementing agency. Vehicles purchased under the project were not being used efficiently and internal controls did not provide reasonable protection against waste or misuse of these resources.

Although the titling process was behind schedule, the Mission stated that an interinstitutional mechanism to provide land titles to small farmers had been fully developed and was in operation, producing more titles than ever before in Honduras (over 20,000 in four years) and collecting valuable information on the rural sector. For instance, during the period 1975-81, INA had issued only 246 provisional titles to peasant groups and only 17 to individuals. Moreover, during the 163-year period, 1820-1983, no more than 7,000 land titles had been issued in the country. For the first time in the history of Honduras, the National Agrarian Institute (INA) and Cadastral Executive Directorate (DEC) were compiling a solid data base of statistics on the nation's rural population. AID officials involved in the project were aware of many of the problems detected during audit and had taken corrective actions.

The audit findings indicated: the project had not attained an acceptable level of performance in meeting its objectives, the operation of the Fixed Amount Reimbursement (FAR) system had not always responded to the needs of the project, INA had not been effective in collecting money owed for titled lands, vehicles purchased for the exclusive use of the project were not being used efficiently and some had been diverted to other uses.

Our recommendations seek to correct the deficiencies encountered during the course of our review. We have recommended that USAID/Honduras obtain from responsible GOH officials a revised implementation plan for the remainder of the project; in consultation with the implementing agencies, devise a procedure to ensure that delineation and mapping activities are provided steady funding; obtain evidence that INA has taken steps to improve collection efforts and determine the possibility of programming funds generated by the project or depositing them in an interest-bearing account; and obtain evidence that INA has established and implemented effective procedures to ensure that vehicles are properly maintained and used for program activities.

A. Findings and Recommendations

1. The Project Was Delayed in Meeting Its Titling Objectives

The project had successfully established a mechanism for adjudicating land titles, but the actual number of titles conferred lagged behind the original project goal. The original goal was to issue about 70,000 land titles to benefit an equal number of farm families during a five-year period. Because it was later found that the goal substantially exceeded the number of eligible farms, USAID/Honduras has amended the project agreement, reducing the number of titles from 70,000 to 40,000. As of July 31, 1986 only 20,430 titles had been delivered. This shortfall occurred because of political problems associated with titling activities and ineffective coordination between the implementing agencies. Unless long-standing implementation problems are effectively addressed, even the revised project objectives may not be reached.

Recommendation No. 1

We recommend that USAID/Honduras obtain from responsible Government of Honduras officials a revised implementation plan for the remainder of the project.

Discussion

Although a titling mechanism had been developed, INA had fallen short in delivering titles to project beneficiaries. The purpose of the project was to establish a functioning mechanism for granting property titles to farmers in Honduras. The project sought to do this by demonstrating the viability of a combined interinstitutional (INA and DEC) and private sector effort focussed on the titling process, conferring a revised total of approximately 40,000 titles on rural families. To accomplish these objectives, AID and the GOH budgeted \$16.7 million (\$12.5 million AID and \$4.2 million GOH).

The Mission stated that an interinstitutional mechanism for titling small farmers had been fully developed and was working. The project continues to compile a solid data base of statistics describing the nation's rural population. For example, almost 47,000 farms of varying sizes and types had been delineated. The data being collected and computerized will be critical for future GOH efforts in titling, land market activities, taxation plans, identification of citizens, etc.

However, the project had not attained its planned level of performance in meeting titling objectives. As of July 31, 1986 the project had formalized only 20,430 (51 percent) land titles of the revised total of 40,000 while four years (80 percent) of project life had elapsed. Only about \$7.3 million (44 percent) of \$16.7 million programmed had been expended. A rotating fund of \$1 million in equivalent local currency resulting from previous Economic Support Fund (ESF) transfers to Honduras was established in October 1985 to finance DEC delineation and mapping

activities. However, it was not considered within the \$7.3 million expended because, although the full amount was exhausted as of August 1986, INA had not certified the work nor liquidated the advance to AID. Subsequent to our audit field work, the Mission informed us that on October 17, 1986 an additional \$1 million in equivalent local currency was added to the rotating fund for delineation and mapping activities.

The Mission found that the original goals of the project were unrealistic. Since the project was to be implemented in coffee producing regions, it was thought that significant numbers of coffee producers would receive titles to their land. This was true in the first department (Santa Barbara), but when work continued in another (Comayagua), project officials found fewer coffee producers than expected. Titles could be issued to coffee growers regardless of farm size, but for non-coffee growers farm sizes were limited between 5 and 50 hectares. These limits reduced the number of potential non-coffee producing beneficiaries. Thus, when Mission officers found a considerably smaller proportion of coffee growers in other departments, they reduced the project objective to 40,000 titles in the seven departments where work was planned.

Political considerations had affected host country support for the project. INA is a GOH agency that has proven to be quite sensitive to changing political currents in Honduras. There had been frequent staff turnover and INA management had changed four times in as many years, resulting in four different project coordinators. Some union leaders from the Agrarian reform sector held strong reservations about the project because they feared that titling land to individuals rather than peasant cooperatives would dilute their political base among rural pressure groups.

Project activities were also hampered by ineffective coordination between the National Agrarian Institute (INA) and the Cadastral Executive Directorate (DEC), and by multiple implementation problems and bottlenecks. INA and DEC blamed each other for low quality work and insufficient finished product due to poor planning, inadequate training, and lack of interest by the personnel involved. For example, a training course scheduled for March 1986 had not taken place as of September 1986 because of delays in the approval process. Additionally, INA and DEC experienced several implementation problems and bottlenecks such as: unusual delays in the procurement of a cartographic computer, causing mapping stoppages for about seven months; careless field personnel, resulting in low quality land delineation; and slow processing of project-related documents.

Finally, sporadic funding for delineation and mapping activities created cash flow problems, contributed to multiple work stoppages, and led to the departure of trained technical personnel at DEC. The USAID project manager, INA and DEC had frequently voiced concerns about the effectiveness of the project's funding mechanism. Unless existing long-standing implementation problems and bottlenecks are effectively addressed, even the revised project titling objectives may not be reached.

Management Comments

In response to this finding, the Mission provided the following comment regarding the figures we used to determine program accomplishments.

The 20,430 titles through July 31 does not represent four full years of work...We would appreciate your including the Mission comparison of 20,430 titles issued against the revised goal of 40,000 titles or an accomplishment of [51]% of the goal.

Since the project is implemented primarily under the fixed amount reimbursement system, your comparisons of the amount of funds expended against the amount programmed should be dropped. We do not accrue expenditures under the land titling portion of the project and, consequently, the amount expended at any given point in time is not a very valid measurement. Considerably more work has been accomplished than the expenditure figure would lead the report reader to believe.

OIG Comments

In our view, the Mission generally agreed with the thrust of our finding and recommendation with the exception of certain matters which have been amended in the report. Our analysis of program accomplishments was based on actual reported data and not based on forthcoming revisions or work accomplishments.

2. The Funding Mechanism for Delineation and Mapping Activities Did Not Always Meet Project Needs

The "front end" of the titling project consists of property delineation and mapping conducted by DEC field brigades. DEC had been funding the brigades for some time from its own budget because of the time required for it to be reimbursed for completed work by INA. Fieldwork had been halted four times because DEC ran out of money to keep its brigades working. This not only delayed project benefits but also caused trained personnel to leave in search of other employment.

Recommendation No. 2

We recommend that USAID/Honduras, in consultation with the National Agrarian Institute and the Cadastral Executive Directorate, devise procedures to ensure that delineation and mapping activities are provided steady funding.

Discussion

The majority of the large land titling effort lay with the delineation of properties to be titled. The delineation and mapping component of the project, absorbing \$10.7 million (64 percent) of the total project funding of \$16.7 million, was to be carried out by DEC under an interinstitutional agreement with INA. DEC's costs for delineation and mapping work were to be paid on a fixed amount reimbursement (FAR) system based on the number of hectares delineated and mapped at a fixed price per hectare. Work in each department was covered by an agreement between INA and DEC which provided for an advance under the FAR system. Those advances could not be liquidated until the delineated work passed through mapping and INA's quality control prior to certification to AID for reimbursement.

The operation of the FAR system under this project was not always smooth because it took considerable time to liquidate the advances received from AID. By their very nature, delineation and mapping activities take a long time to complete. Therefore, large book balances of unliquidated cash advances remained outstanding even though the cash itself had been completely used months before. As a result, funds to continue work in other departments could not be authorized until those advances were liquidated.

DEC had often complained about running out of money to carry out its delineation and mapping activities. To alleviate cash flow problems, a revolving fund of \$1 million in equivalent local currency generated by Economic Support Fund (ESF) transfers was established in October 1985 for DEC's use. These funds were deposited in a special account at the Central Bank of Honduras. DEC's monthly project expenses were reported via reimbursement vouchers sent through INA, the Ministry of Natural Resources and the Ministry of Finance. DEC financed the expenses incurred for delineation and mapping from its own funds, which were later

reimbursed. Subsequent to our audit field work, the Mission informed us that on October 17, 1986 an additional \$1 million in equivalent local currency was added to the rotating fund for delineation and mapping activities.

We found that it took an average of nine weeks to process each of the first eight reimbursements requested by DEC. DEC had requested 11 reimbursements from INA for a total of \$1,000,011, but Nos. 9, 10, and 11 of July 31, August 6, and August 28, 1986, respectively, (totaling \$170,409) had not been received by DEC as of October 16, 1986. Three sets of documents supporting the expenses incurred by DEC for the project were being prepared for the three GOH institutions involved in processing the reimbursement, thus resulting in additional costs and cumbersome processing of the reimbursement.

DEC had to suspend delineation and mapping activities six times during the life of the project. Four interruptions were due to cash-flow problems; two of these occurred after the revolving fund was created. According to DEC management, the four suspensions delayed implementation for 101 days (4-1/2 months) and cost the program around \$112,034 in salaries. The two suspensions that occurred after the revolving fund was created cost the program \$59,899. These costs were not financed by the U.S. Government due to the operation of the FAR system, which established a fixed price per hectare of land delineated for AID reimbursement.

The work stoppages prompted DEC to temporarily suspend employees who had been contracted and trained for the project. When cash-flow resumed, some of the employees were no longer available. Consequently, new employees had to be hired and trained. In other instances, the employees were given advance leave because there was no money for their field trip expenses. In mid-August 1986, DEC employees working for the project had not been paid their salary for the month of July, and delineation brigades were working in the field without travel advances because of a lack of funds. This stop-and-start funding situation not only added costs to the project, but prevented DEC from gaining momentum to meet project objectives.

Liquidations of local currency revolving funds used were to be processed via a FAR system of certifications; in other words, the revolving fund could not be replenished until INA certified DEC's work to AID. As of September 12, 1986 DEC had submitted 189,799 hectares of work delineated and mapped in the Department of Copan. This represented about \$430,465 in advances awaiting INA's quality control and certification. Delineation results and documentation supporting the use of the \$1 million in revolving funds was at INA and the Ministry of Finance. These expenses were already incurred by DEC for delineation in the department of Cortes. Thus, while a revolving fund had been established, it was not functioning well because replenishments were delayed. None of the reimbursement requests submitted by DEC had been replenished because they had not been certified to AID by INA.

DEC's monthly expenses for delineation and mapping were about \$80,000 and it required advances for at least three months, or \$240,000. As originally conceived, reimbursements were to be requested for expenditures and the revolving fund replenished regularly. However, this was not possible because it took several months to submit finished products to INA.

Creation of the revolving fund had obviously not completely solved DEC's liquidity problems. In the ten months after the revolving fund was established, the \$1 million was exhausted and none of the work done by DEC had been certified and liquidated by INA.

At the conclusion of our field work, DEC was developing a different financial mechanism for future work in the Department of Yoro which we considered a spontaneous and creative approach to the problem. This financial mechanism, which had not yet been presented to INA, would recover the expenses incurred by DEC at a higher rate during early months (delineation), and at a lower rate during the last months (mapping) in a particular geographic area. Reimbursement on such a basis could ensure a steady flow of funds to DEC. The delineation phase is when most of the employees are needed and when more expenses are incurred.

Management Comments

In response to our finding, the Mission made the following comments:

We fully concur with the first part of the recommendation to explore ways to ensure that delineation brigades and mapping activities are provided steady funding. The first step in accomplishing this has been taken with the issuance of a PII to increase the ESF rotating fund from 2 million lempira to 4 million lempira [\$1 = 1.2]....The DEC internal document attached to the RAF is just one of a number of potential solutions....

Later, in responding to our draft audit report, the Mission indicated that the different financial mechanism developed by DEC and presented in the discussion section of the finding

is now a moot point since all parties have agreed on new operating procedures and increased funding for the rotating fund. The Executive Director of DEC, as well as INA, MOF and USAID, are all completely satisfied that a steady source of funding has been obtained for the project.

The Mission went on to say that:

The rotating fund was initially established at the level of \$1 million in equivalent local currency,...the rotating fund has now been increased by another \$1 million in equivalent local currency and, in the opinion of INA, DEC, MOF [Ministry of

Finance], and USAID is sufficient with the periodic reimbursements from project funds to ensure a steady funding source for the project.... Implementation Letter No. 27 dated November 24, 1986 which, among other things, provides for up to a three month advance from the rotating fund for DEC's anticipated needs for the mapping work completed and work in progress. Although DEC did not sign the PIL, they were in complete accord that their financing problem has been resolved.

OIG Comments

After receiving the Mission Comments on our draft audit report, we contacted the Executive Director of DEC on January 8, 1987. He stated that DEC remained interested in recovering expenses incurred at a higher rate during the delineation work and at a lower rate during the process of mapping. In fact, DEC had submitted to INA a formal proposal along these lines for future work in the Department of Yoro. He also stated that the additional \$1 million in equivalent local currencies would only be sufficient to complete work in process in the Departments of Copan and Cortes.

Subsequent contacts with the Mission revealed that it was USAID/Honduras' position that whatever reimbursement system DEC wishes to use, the new revolving fund total should be sufficient to accommodate its operation. Given this assurance by the Mission, we are closing recommendation No. 2 upon issuance of this report.

3. Little Agrarian Debt Was Being Collected

The project agreement provided that title recipients were to pay a fair purchase price which would help fund continued titling efforts. However, poverty, logistical problems and an ineffective collection campaign led to a 95 percent delinquency rate. Furthermore, the amount that had been collected was neither being used for the project nor earning interest. A lack of such income could hamper further titling activities.

Recommendation No. 3

We recommend that USAID/Honduras obtain evidence that the National Agrarian Institute has:

- a) taken steps to improve collection efforts;
- b) determined the future use of funds generated by the project or deposited them in an interest-bearing account.

Discussion

According to the project agreement, beneficiaries were to pay (in full or in installments) the purchase price of the land for which title was being granted as negotiated with INA under the terms and conditions specified in the Agrarian Reform Law and Decree No. 78 of 1981. The funds were to be used to continue financing further project activities in other departments.

We found that INA's efforts to collect the agrarian debt had been ineffective and the funds collected were neither being used nor collecting interest. INA had not collected \$1,065,362 (in arrears more than three months) of the \$1,121,642 that had become due, resulting in a delinquency rate of 95 percent. Further, our field visits to 20 beneficiaries selected at random in the Departments of Santa Barbara and Comayagua showed that only \$155.87 (8.7 percent) of their agrarian debt of \$1,785.55 had been paid to INA. In fact, INA had collected a total of only \$240,511 from project beneficiaries as of August 22, 1986. These funds had been deposited in a non-interest bearing bank account at the National Agricultural Development Bank. Although INA had agreed to devote all funds generated from the sale of national lands being titled under the project to the continuation of project activities, we found these funds were lying idle.

The high delinquency rate of the agrarian debt was caused by poverty, logistical difficulties and INA's ineffective collection efforts. The title recipients' poor economic condition had been worsened by a coffee blight in Santa Barbara, making payments very difficult. Most title recipients lived in very remote areas, far from the banks where they were to make payments. Finally, INA was not promoting debt payment. In one case we found a title beneficiary who was willing to pay his debt in full, but his spouse had suggested not paying since INA was not pressing the matter. In other cases beneficiaries felt they would be paying for land they already owned or had effectively possessed for years, although the vast majority of interviewed beneficiaries recognized the benefit of legal title.

Non-collection of the agrarian debt could jeopardize continuing project activities in other departments especially after AID funding ceases. In addition, had the funds lying idle at the Bank been placed in an interest bearing account at seven percent, an additional \$21,618 would have been generated for project activities.

Management Comments

The Mission agreed with our finding but suggested redirecting the thrust of our recommendation towards determining the cost-effectiveness of a more aggressive collection policy.

OIG Comments

We believe our recommendation properly addresses the cause of the condition discussed in our finding. In addition, we view the issue of agrarian debt payment as an important matter of principle and fundamental to the viability of this activity in the future. Thus, we have maintained our recommendation as originally drafted.

4. Vehicle Use and Maintenance Practices Sideline Project Resources

The project provided 35 vehicles which were to be maintained by INA and used for project activities. Due to a need for repairs or diversion to other uses, about a third of the vehicles were not available during the period sampled. INA's inadequate controls in this area were illustrated by incomplete vehicle maintenance and use records. The lack of an effective maintenance program and the diversion of vehicles to unauthorized uses impeded the project from using AID-provided resources to meet planned objectives.

Recommendation No. 4

We recommend that USAID/Honduras obtain evidence that the National Agrarian Institute has:

- a) established and implemented effective procedures to ensure that vehicles are properly maintained and used for program activities; and
- b) returned to project use four vehicles assigned to the Bajo Aguan Valley.

Discussion

The project agreement provided \$426,825 to procure 35 vehicles. These vehicles were to be properly maintained and were to be used in project-related activities only.

The audit found that many of the vehicles were not available for project use because they required repairs or had been diverted to unauthorized uses. We also found that only incomplete maintenance and utilization records were available for inspection, suggesting that such records had not been adequately maintained.

Repairs - A visit to INA's repair shop in Tegucigalpa found that 12 of the AMC CJ8 Jeeps procured for the project had been out of service awaiting repairs for periods ranging from one week to three months (one of the vehicles had been damaged in an accident). We were told by INA officials that the reason the vehicles had not been repaired was owing to a lack of spare parts.

Diversion - Some vehicles were unavailable for field use because they were loaned out to other projects in the Aguan Valley, stood idle in the INA motor pool or were being used for personal business. Four vehicles were assigned to the Bajo Aguan Valley for activities not related to the Small Farmer Titling Project. Furthermore, a two-month sample of the vehicle control log indicated that about eleven vehicles were idle on any one day and that vehicles were occasionally being used for personal business. Since entries were incomplete, unauthorized vehicle use may actually have been higher. INA neither ensured proper use of the vehicles nor properly monitored actual use and maintenance.

The lack of an effective maintenance program and the diversion of vehicles to other uses were preventing the project from using AID-provided resources to meet planned objectives. While these vehicles remained idle or were being used for non-project activities, DEC management complained that it lacked vehicles to provide adequate field transportation to delineation brigades.

Management Comments

In response to this finding the Mission stated that they had requested return of the vehicles assigned to the Aguan Valley.

OIG Comments

Based on the Mission's comments, part b) of recommendation No. 4 is closed upon issuance of this report.

B. Compliance and Internal Controls

1. Compliance

There were two compliance exceptions:

- Funds generated by the project were neither used to continue financing similar project activities nor earning interest.
- Vehicles purchased for the exclusive use of the project were not being properly maintained.

Other than the conditions cited, tested items were in compliance with applicable laws and regulations, and nothing came to our attention that would indicate that untested items were not in compliance with applicable laws and regulations.

2. Internal Controls

We noted two internal control exceptions:

- The implementing agency did not provide adequate controls over the use and maintenance of vehicles. The vehicles purchased for the exclusive use of the project were not being used efficiently or had been diverted to other uses.
- INA lacked effective collection procedures for lands sold to project beneficiaries, resulting in a 95 percent delinquency rate and over \$1 million in arrears for 90 days.

C. Other Pertinent Matters

Voltage Regulator - During the course of our audit we found that a voltage regulator procured to protect the Cadastral Executive Directorate's (DEC) computer against power surges had not functioned since April 30, 1986 leaving the computer with limited protection. The Mission agreed that the voltage regulator needed to be repaired. They stated that the Cadastral Executive Directorate (DEC) had contacted the manufacturer, Topaz Corporation, which had determined that the voltage regulator was still under warranty. The Central America representative of Topaz in Guatemala sent a technician who analyzed the problem and secured the necessary parts for repair of the equipment. The parts have been installed in the voltage regulator and the equipment is reported to be working well.

Copiers - Two copying machines had been transferred from INA's Implementation unit (Land Titling Office - PTT) to its Division of General Services. These machines were procured with counterpart funds and were to be used for the project. The machines were transferred because the Director made a decision to centralize certain INA operations. According to the project agreement, INA had agreed to provide all other resources required to carry out the project in a timely and effective manner. Since the copying machines were centrally located, the AID project implementing office had been subject to a series of clearance procedures imposed by the headquarters office. As a result, there had been delays in the retrieval of information necessary to effectively and efficiently implement the project.

In response to our finding, the USAID/Honduras Mission Director sent a letter to INA's Executive Director requiring the return of the two copying machines to PTT. In reply to this letter, the Executive Director assured the Mission that the machines will be used only for project purposes and that adequate service for making copies will be available to PTT. The Mission and RIG concurred that, since the equipment was bought with Government of Honduras funds, and since centralization may result in lower overall costs to INA, the centralized process should be given a fair trial. The Mission has instructed the project manager to monitor how the procedure is operating and will raise the issue if adequate service is not rendered to the PTT.

Commercial Credit - The project aimed to make commercial credit more available to small farmers by conferring mortgageable legal land titles. But titles alone proved to be insufficient collateral in the eyes of commercial lenders and a complementary credit project was not available to many beneficiaries. Beneficiaries needed to have farm improvements or other assets such as cattle or crops to be eligible for credit. The National Agricultural Development Bank branch in Santa Barbara confirmed this policy. Nor was sufficient credit available through another AID funded project, Small Farmer Coffee Improvement, which was to complement the Small Farmer Titling Project. We believe that the lack of credit necessary to work the farms may jeopardize the project goal of increasing food production and farmer income.

In response to the credit issue, the Mission stated that they are presently undertaking a definitive study of credit mechanisms and constraints in the Honduran economy. For these and other reasons, the Mission is not at the moment considering a credit component for this project.

AUDIT OF USAID/HONDURAS'
SMALL FARMER TITLING PROJECT NO. 522-0173

PART III - APPENDICES

MEMORANDUM

December 31, 1986

TO: Coinage Gothard, RIG

FROM: John Sanbrailo, Mission Director

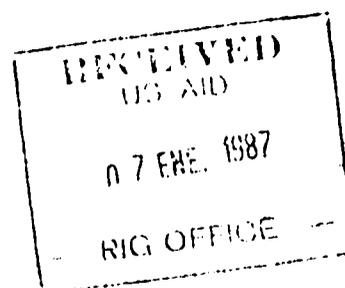
SUBJECT: Response to the Draft Audit Report, Small Farmer Titling Project
No. 522 0173

Attached is the Mission's response to the subject draft report. In general, we are pleased to see that portions of our comments made on the Records of Audit Findings furnished to us earlier in the audit process have been incorporated in the draft audit report.

We have continued our efforts to implement the remaining open recommendations (see attached letter from the Acting Director dated 11/12/86 to the Executive Director of INA) and believe that action taken on recommendation number two is sufficient to have the recommendation closed upon publication of the final report. We anticipate that the remaining recommendations will be closed within the next several months.

We have additional comments and observations on the draft report which we believe will give more balance to an essentially sound report. Once again, we would like to state our appreciation for your making staff available to audit this important and politically sensitive project.

Attachments a/s



RESPONSE TO FINDINGS/RECOMMENDATIONS OF THE RIG SMALL FARMER TITLING AUDIT
PROJECT 522 0173

In our view, better balance would be achieved in the Executive Summary and the Results of Audit if the report presented the positive findings and conclusions first. We suggest that you give consideration to moving paragraph six which reads "The project had successfully established" to paragraph three and moving the current paragraph 3 to paragraph 5. Similar changes could be made in the Results of Audit section to improve the reporting balance.

The sentences in the third paragraph of the Executive Summary on page i and in the first paragraph of the Results of Audit on page 5 which read "The funding mechanism for delineation and mapping activities was unsuitable.", are materially different than the conclusion reached in the finding that "The operation of the Fixed Amount Reimbursement system proved unsuitable for this project because it took considerable time to liquidate the advances received from AID." The way the two sentences are now structured indicates to the reader that the FAR system itself, as opposed to the operation of the initial FAR mechanism (i.e. before the establishment of the ESF funded revolving fund), is unsuitable for this project. We disagree with this inference and believe that the FAR system tends to promote economies in getting the job done. AID Handbook 3 recognizes the benefits from the FAR method and urges field Missions to apply the method as often as possible. We believe the report also should recognize the advantages of the FAR method and our efforts (explained more fully below) to insure that the system works in providing adequate funding to the implementing agencies at the least cost to the U. S. Government. Moreover, we think the sentences on page i and page 5 should be appropriately modified.

The third sentence in paragraph 3 of the Executive Summary (and the equivalent sentences on pages ii, 5, 6 and 26) which reads "Equipment and vehicles purchased under the project were not being used efficiently and internal controls did not provide reasonable protection against waste or misuse of resources." requires correction. The only equipment mentioned in the report where efficiency of use was questioned consists of the two copying machines purchased with Government of Honduras funds and which were centralized to achieve economies in operations. RIG has concurred that the centralization process should be given a fair trial. We request that the word "equipment" be dropped from the sentence and that the word "these" be inserted before the word "resources" to clearly indicate that the report is only talking about the vehicles.

On page ii of the Executive Summary, we suggest that you change the word "some" in the last sentence of the first paragraph to read "most". The last sentence in the first paragraph would then read ". . . were aware of most of the problems detected during audit and had taken corrective action." We believe that this is a more accurate statement since the project officer was essentially aware of all of the problems mentioned in the draft report with the sole exception of INA's transfer of four PTT vehicles to the Bajo Aguan. The first full sentence on page 6 should be changed in the same manner.

On page iv of the Executive Summary (and the equivalent sentence on page 25), we suggest that you change the last sentence on the page to read "The Mission has requested return of the vehicles." As indicated in the attached letter from the Acting Director to INA, we have instructed INA that the four vehicles in question have to be returned to PIT.

In the first paragraph on page 3 (also in the equivalent sentences on pages 9, 10 and 15) we believe the report should note that on October 17, 1986 an additional \$1 million in equivalent local currency was added to the rotating fund for delineation and mapping activities. On page 9 in the first paragraph, you should remove IHCAFE as part of the interinstitutional effort. Only INA and DEC are part of the interinstitutional base that deals with the project's titling process. The last sentence on page 10 which reads "Peasant leaders" would be more accurate if restated to read "Some, but not all, union leaders from the Sector Reformado held strong"

On page 15, we suggest that you insert the word "original" before the word "FAR" in the first sentence of the second paragraph. The sentence would then read, "The operation of the original FAR system". Initially, the Mission used advances of AID project funds (an acceptable variation of the FAR system) to defray FAR expenses since Honduras did not have sufficient resources to provide the required working capital to INA/DEC. Once the ESF cash transfer program started generating local currencies which the Mission could jointly program with the Government of Honduras to provide counterpart support to our project portfolio, sound cash management principles dictated that we establish rotating funds where possible and limit the dollar cash advances that were being used to support our projects. In the case of the Land Titling Project, the move to host country financing of the delineation effort presented us with a golden opportunity to reduce the overall cost to the U.S. Government and to reduce the old outstanding advance balances under this project.

The rotating fund was initially established at the level of \$1 million in equivalent local currency, however, it was recognized at the time of establishment that the rotating fund would have to be increased to fully cover the project needs. Although negotiating the increase with the GOH led to some delay, the rotating fund has now been increased by another \$1 million in equivalent local currency and, in the opinion of INA, DEC, MOF,* and USAID is sufficient with the periodic reimbursements from project funds to ensure a steady funding source for the project. Even using the figures in your report of \$240,000 a quarter required by DEC and documentation supporting the use of the initial \$1 million in the rotating fund in INA and MOF, one can quickly see that in excess of a year in funding is available in cash and another year of funding is awaiting certification. We are attaching a copy of Implementation Letter no. 27 dated November 24, 1986 which, among other things, provides for up to a three month advance from the rotating fund for DEC's anticipated needs for the mapping work completed and work in progress. Although DEC did not sign the PIL, they were in complete accord that their financing problem has been resolved.

* Ministry of Finance.

The last sentence in paragraph two on page 15 is misleading. The sentence indicates that large amounts of cash advances remained outstanding. We believe that it is more appropriate to state that large balances of unliquidated advances remained outstanding even though the cash had been completely used months before.

On page 16, we are uncertain as to how the cost to the program of \$112,034 is computed by DEC and believe that RIG should independently verify that such costs are reasonable and can properly be attributed to the program or the figures should be dropped from the report. In any event, we believe that RIG should make it perfectly clear that these costs, even if reasonable and allocable, are in no way financed by the U. S. Government due to the operation of the FAR system. Under FAR, the price per hectare of land delineated is fixed, and the incentive is for the Host Country to do the job within the cost estimates. Moreover, as we pointed out earlier, we believe that the FAR system has lessened the costs to both the U. S. Government and the Government of Honduras.

On page 17, we believe that the penultimate sentence in the last paragraph should be amended. A more accurate sentence would be "The revolving fund as initially capitalized did not fully solve DEC's liquidity problems." To state that the revolving fund had not contributed to this solution is simply incorrect.

We believe that the second paragraph on page 18 which extols an internal DEC plan that would have created a different financial mechanism is now a moot point since all parties have agreed on new operating procedures and increased funding for the rotating fund. The Executive Director of DEC, as well as INA, MOF, and USAID, are completely satisfied that a steady source of funding has been obtained for the project. We request that you delete this paragraph and Part III - Appendices from the report.

Based on our analysis using your figures, we further request that you drop the last sentence on page 19. We do not believe that such a conclusion can be drawn from any reasonable analytical approach to our solution to the cash flow problem.

We believe that the action taken on Recommendation No. 2 is sufficient to have the recommendation closed upon publication of the final report and hereby request that you do so.

List of Recommendations

	<u>Page</u>
<u>Recommendation No. 1</u>	4
We recommend that USAID/Honduras obtain from responsible Government of Honduras officials a revised implementation plan for the remainder of the project.	
<u>Recommendation No. 2</u>	7
We recommend that USAID/Honduras, in consultation with the National Agrarian Institute and the Cadastral Executive Directorate, explore ways to ensure that delineation and mapping activities are provided steady funding.	
<u>Recommendation No. 3</u>	11
We recommend that USAID/Honduras obtain evidence that the National Agrarian Institute has:	
a) taken steps to improve collection efforts;	
b) determined the future use of funds generated by the project or deposited them in an interest-bearing account.	
<u>Recommendation No. 4</u>	13
We recommend that USAID/Honduras obtain evidence that the National Agrarian Institute has:	
a) established and implemented effective procedures to ensure that vehicles are properly maintained and used for program activities; and	
b) transferred back to the project four vehicles assigned to the Bajo Aguan Valley.	

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