PD-AAX-...

ISN-54143

AUDIT OF USAID/EL SALVADOR
SMALL PRODUCER DEVELOPMENT
PROJECT NO. 519-0229 (B)

Audit Report No. 1-519-88-03
December 23, 1987

U. S. MAILING ADDRESS:
RIG/T
APO MIAMI 34022

AGENCY FOR INTERNATIONAL DEVELOPMENT

OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

TELEPHONES
32-9987
also 32-3120 EXT. 2701-2703

December 23, 1987

MEMORANDUM

TO : USAID/EL Salvador Mission Director, Henry Bassford

FROM : RIG/A/T, Coinage N. Gothard, Jr. Coinage N. Gothard

SUBJECT : Audit of USAID/El Salvador Small Producer Development Project No. 519-0229 (B)

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of the USAID/El Salvador Small Producer Development Project No. 519-0229 (B). Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains 1 recommendation which is considered unresolved. Please advise me within 30 days of any additional actions taken to implement Recommendation No. 1.

I appreciate the cooperation and courtesy extended to my staff during the audit.

EXECUTIVE SUMMARY

The Rural Community Development program was established under the Small Producer Development Project and managed by the Federation of Credit Institutions. The project sought to establish an efficient credit system through which AID and Government of El Salvador counterpart funds would be made available to credit-needy rural and urban Salvadorans. AID funds of $14.25 million were to provide training and technical assistance to the Federation, its 61 affiliated agencies and beneficiaries. Of the total obligated funds, $9.7 million were used to establish a Small Producer Development Credit Fund.

At the request of USAID/El Salvador, the Office of the Regional Inspector General for Audit/Tegucigalpa made a program results audit of the Federation of Credit Institutions. The audit was performed because USAID/El Salvador was considering channeling additional funds through the Federation to support similar project activities. Specifically, the audit sought to determine if the Rural Community Development Program was an efficient and effective credit system and had been administered in accordance with AID regulations and project agreement provisions.

The audit found that the Small Producer Development Project had not developed an efficient and effective credit approval and management system, and that certain aspects of the program were not in compliance with the project agreement provisions.

Although the project had not met its institution-building objectives, it had been successful in channeling needed credit to beneficiaries. The number of credit agencies operating under Federation management umbrella increased from 42 to 61, and 22,699 loans valued at $36.1 million were approved under the three funds comprising the Federation's Rural Community Development Program. The audit found that these loans had produced heartening results. Because they were members of the communities served, local credit agency officials and employees had shown a high degree of dedication to their work and real willingness to reach out to the marginal urban and rural poor.

However, in order to be effective and efficient, the system needed a certain amount of restructuring, redirection, and financial controls to better serve the affiliated credit agencies as well as deserving Salvadorans. The audit found that: the Federation had not (1) identified and/or addressed systemic management weaknesses which could be corrected with technical assistance, training and other appropriate measures, (2) fully established an adequate information system to provide it and its member credit agencies with timely and accurate information to effectively monitor and plan program operations, or (3) streamlined operations by delegating more responsibility for credit operations to member credit agencies.

An important objective of the amended grant and loan agreement was to improve the institutional capabilities of the Federation to manage credit programs efficiently through the rural credit agencies. Although a number of evaluations proposed training and technical assistance to strengthen the institutional capability of the system, the Mission had been unable to persuade the Federation to implement all of the recommendations. Without adequate technical assistance, the local credit agencies could not always manage the credit program effectively. Loan proposals and beneficiaries were not adequately screened, beneficiaries did not receive appropriate training and there was little follow-up on loan use. Neither the Federation nor the agencies had adequate systems to monitor or manage loan recoveries. As a result, not only were the local agencies not learning sound credit practices, but loan delinquencies were high. Since the project completion date was September 1986 and the Mission was unable to negotiate policy changes with the Federation they considered essential for a follow-up project, we recommended that the remaining $3.6 million in AID funds be deobligated.

The grant and loan agreements required the borrower, in this case the Federation, to maintain adequate books and records. The Federation received money for loans from three separate funds, but did not separately account for the use of this money. As a result, the Federation lacked timely and reliable information for decision making and for monitoring and reporting on AID- and Government of El Salvador-provided funds. The Mission had not initially required separate accounting because it felt the necessary information could be derived from the current system. It has since provided equipment for a computerized accounting system, which will be completely operational by mid-1988.

The audit found that unnecessary duplication existed in the project's credit operations because the Federation of Credit Institutions had not delegated responsibility for credit approval to its affiliated credit agencies. The project agreements provided that the Federation of Credit Institutions, to the maximum extent feasible, would decentralize its credit operations by assigning operational responsbility and management authority to its affiliated credit agencies, so as to strengthen their institutional capabilities and to improve the program's efficiency. The Federation did not want to relinquish its control over the approval process because of concerns that its affiliated agencies would not adhere to the project's loan eligibility criteria. As a result, efforts were duplicated, loans were delayed and the institution-building aspect of the project was hampered.

The Mission generally agreed with the findings as presented at the exit conference, however there is a difference of opinion on the possibility of extending the project.

Office of the Inspector General

AUDIT OF USAID/EL SALVADOR
SMALL PRODUCER DEVELOPMENT
PROJECT NO. 519-0229 (B)

TABLE OF CONTENTS

AUDIT OF USAID/EL SALVADOR
SMALL PRODUCER DEVELOPMENT
PROJECT NO. 519-0229 (B)

PART I - INTRODUCTION

A. Background

The Rural Community Development Program was established under the Small Producer Development Project, No. 519-0229(B), and managed by the Federation of Credit Institutions (FEDECCREDITO). The project sought to establish an efficient and effective credit system through which AID and Government of El Salvador (GOES) counterpart funds would be made available to credit-needy rural and urban Salvadorans. To help establish such a system, AID funds were made available to finance technical assistance and training for FEDECCREDITO and its member credit agencies for the purpose of strengthening their institutional and management capabilities. In addition, AID training funds were also made available to assist project loan recipients with improving their management skills and capabilities.

The Federation of Credit Institutions (FEDECCREDITO) is a quasi-public-sector federation consisting of 61 affiliated credit agencies operating throughout El Salvador. AID funds of $14.25 million ($9.25 million grant and $5 million loan) were obligated to provide training and technical assistance to FEDECCREDITO, its affiliated credit agencies and to selected recipients of loans from these credit agencies. Of the total obligated funds, $9.7 million were used to establish a Small Producer Development Credit Fund (Spanish acronym-DPP) to provide credit assistance to urban and rural poor.

Two additional credit funds were established with GOES counterpart funds to complement the objectives of the AID funded Small Producer Development Credit Fund. The Special Fund for National Reconstruction (Spanish acronym-FERN) was established to finance business activities of small producers who were directly affected by civil conflict. The Special Program for Rural Micro-Enterprises (Spanish acronym-PEMER) was established to finance business activities of small rural enterprises in need of working capital and capital investment. As of December 31, 1986, these two funds had disbursed the equivalent of $3.7 million and $9.5 million respectively in counterpart funds.

The three funds - DPP, FERN and PEMER - were administered by FEDECCREDITO through its affiliated credit agencies and were collectively known as FEDECCREDITO's Rural Community Development Program.

The project ended on September 30, 1986. Requests for disbursement were to be received by A.I.D. not later than nine (9) months following the project activity completion date. USAID/El Salvador's controller records, as of March 31, 1987, showed that $10.65 million of the $14.25 million in AID funds had been disbursed by FEDECCREDITO.

B. Audit Objectives and Scope

At the request of USAID/El Salvador, the Office of the Regional Inspector General for Audit/Tegucigalpa made a program results audit of the Federation of Credit Institutions, one of the two credit institutions funded under the Small Producer Development Project, No. 519-0229(B) 1/. The audit was performed even though the project assistance completion date had passed, because USAID/El Salvador was considering channeling additional funds through FEDECCREDITO to support similar project activities. Specifically, the audit sought to determine if the FEDECCREDITO-managed Rural Community Development Program was an efficient and effective credit system and had been administered in accordance with AID regulations and project agreement provisions.

To accomplish these objectives, program files, records and other pertinent data were reviewed at USAID/El Salvador, FEDECCREDITO and selected affiliated credit agencies. Officials of USAID/El Salvador and Government of El Salvador were interviewed and field visits were made to 13 of 61 credit agencies currently operating under the FEDECCREDITO system. At these locations, a random sample of 155 credit files were reviewed and interviews with 115 of 10,499 program beneficiaries with credit balances outstanding were conducted. Information on the sites visited and information reviewed is shown in Exhibit 1.

The audit relied on a number of other reports and evaluations to supplement the audit work. These documents are listed in Exhibit 2. In addition, two private auditors from the company of Esquivel & Esquivel were contracted to assist the audit team in conducting interviews with the 115 program loan recipients. The selection of the 13 credit agencies and, to a limited extent, the selection of program beneficiaries was affected by security conditions in the country at the time of the audit.

The audit included activities from February 27, 1980 to March 31, 1987, and covered $10.7 million in AID disbursements, of which $1.5 million in program expenditures were reviewed. Internal controls were examined as they related to selection of program beneficiaries, disbursements of credit proceeds, follow-up on credit utilization, and collection of credit repayments.

The audit was conducted from March 18, 1987 to May 27, 1987 and was made in accordance with generally accepted government auditing standards.

1/ The other credit institution - Credit Union Federation (Federacion de Asociaciones Cooperativas de Ahorro y Credito, FEDECACES) was not included in this audit because AID funding for this entity under the Small Producer Development Project was stopped on September 26, 1984 because FEDECACES was unable to utilize AID monies efficiently.

AUDIT OF USAID/EL SALVADOR
SMALL PRODUCER DEVELOPMENT
PROJECT NO. 519-0229 (B)

PART II - RESULTS OF AUDIT

The audit found that the Small Producer Development Project had not developed an efficient and effective credit approval and management system, and that certain aspects of the program were not in compliance with the project agreement provisions.

Although the project had not met the institution-building objectives of strengthening its member institutions, it had been successful in channeling needed credit to beneficiaries. The number of credit agencies operating under FEDECCREDITO's management umbrella increased from 42 to 61 and 22,699 loans valued at $36.1 million were approved under the three funds comprising FEDECCREDITO's Rural Community Development Program. The audit found that these loans had produced heartening results. For example: a tailor was able to contract for the production of uniforms for two institutions and added four employees; a small businessman increased his production of tomato sauce and also added four employees; and a small family-owned shoe shop and textile (sporting goods) factory received a working capital loan and was able to increase production and maintain a larger inventory to meet demand.

Because they were members of the communities served, local credit agency officials and employees had shown a high degree of dedication to their work and real willingness to reach out to the marginal urban and rural poor whose credit needs were well known to them, and the beneficiaries considered themselves well received and served. Thus these agencies represented a potentially effective credit mechanism to channel AID and GOES assistance to the credit-needy.

However, in order to be effective and efficient, the system needed a certain amount of restructuring, redirection, and financial controls to better serve the affiliated credit agencies as well as deserving Salvadorans. The audit found that: FEDECCREDITO had not (1) identified and/or addressed systemic management weaknesses which could be corrected with technical assistance, training and other appropriate measures, (2) fully established an adequate information system to provide it and its member credit agencies with timely and accurate information to effectively monitor and plan program operations, or (3) streamlined operations by delegating more responsibility for credit operations to member credit agencies. Since the project is no longer active, this report makes no formal recommendations to improve operations. It does recommend deobligating the remaining AID funds.

A. Findings and Recommendation

1. Credit Agencies Needed to Improve Credit Practices

An important objective of the amended grant and loan agreements was to improve the institutional capabilities of FEDECCREDITO to manage credit programs efficiently through the rural credit agencies. Although a number of evaluations proposed training and technical assistance to strengthen the institutional capability of the system, the Mission had been unable to persuade FEDECCREDITO to implement all of the recommendations. Without adequate technical assistance, the local credit agencies could not always manage the credit program effectively. Loan proposals and beneficiaries were not adequately screened, beneficiaries did not receive appropriate training and there was little follow-up on loan use. Neither FEDECCREDITO nor the agencies had adequate systems to monitor or manage loan recoveries. As a result, not only were the local agencies not learning sound credit practices, but loan delinquencies were high. The project completion date was September 1986 and the Mission was unable to negotiate policy changes with FEDECCREDITO they considered essential for a follow-up project. The remaining AID funds should therefore be deobligated.

Recommendation No. 1

We recommend that USAID/El Salvador deobligate the $3.6 million in AID funds remaining from the Small Producer Development Project.

Discussion

The purposes of the amended grant and loan agreements were to improve the institutional capabilities of FEDECCREDITO to manage credit programs efficiently through its rural credit agencies. To accomplish this, technical assistance and training were to be provided to FEDECCREDITO and member agencies, with major emphasis on the credit agency level to aid decentralization. Four model agencies were to demonstrate desired procedures.

Amendatory Agreement No. 1 to the Grant Agreement, Section I B of Annex I, states that:

> The Amendment will support improving institutional capabilities to manage credit programs efficiently through the rural credit agencies. In order to achieve this, training of agency and Federation officials will be continued and expanded to cover credit analysis and supervision, portfolio management, and information management systems. Major emphasis will be placed on the credit agency (Cajas) level. This core training will serve as a basis for initial steps in decentralizing the decision-making process within the system.

Various studies had been conducted under the project in anticipation of the provision of technical assistance and training (Exhibit 2). These documents included many important recommendations designed to improve the institutional capability of the system. One of the improvements, computerized information and management system was slowly becoming a reality, however, implementation of many other recommendations had not been fully achieved. Among unresolved matters were credit policy issues, delinquent accounts analysis, operating expense ratio, interest spread, savings mobilization and internal capitalization, decentralization and accounting procedures.

Although some technical training had been provided under the program, the need for complementary technical assistance was evident during the audit field work.

Screening Procedures -- FEDECCREDITO's internal procedures required a profile or feasibility study for each small producer loan of $1,000 and over. These studies were needed to establish the financial viability of the small producer project. The auditors reviewed 155 beneficiary credit files. Of the 100 loans for $1,000 or more, 83 percent did not include a profile or feasibility study. The main reasons for this situation were a combination of scarce human resources and laxity on the part of the agencies. This factor could be contributing to the delinquency situation of the program, as 34 of the 83 beneficiaries lacking studies were found to be in arrears.

In addition, inadequate screening of beneficiaries allowed funds to be loaned to people who did not meet program requirements. The credit manual for the Small Producer Development Project provided that loan applicants could not exceed an asset limitation of $20,000 and that their principal activity and the main source of income were to be from small producer activities. The audit found that 14 percent of the 115 beneficiaries interviewed exceeded the asset limitation of $20,000, and that 19 percent were not dedicated mainly to small producer activities. This situation existed because the agencies had failed to verify the information on the loan applications and had been lax in enforcing compliance with program requirements.

Beneficiary Training -- Program beneficiaries were to be provided with the basic technical and administrative skills needed to make their enterprise financially viable. The audit found that little technical and administrative training assistance had been provided to those participating in the program. In fact, personal interviews with 115 program beneficiaries selected at random showed that only 2 beneficiaries had received some sort of training and 9 had received technical assistance from FEDECCREDITO. One beneficiary complained that the business administration course he had received was too sophisticated for his educational background. Field visits to program beneficiaries confirmed the need for technical and administrative training assistance, especially for non-agricultural small businesses, which had not received any assistance at all. Small farmers were receiving some degree of technical assistance from FEDECCREDITO agronomists assigned to the agencies, but these efforts needed further improvement.

This situation existed because FEDECCREDITO had addressed its training efforts to all community members wanting to receive training, not just those participating in the program. Reportedly, as of January 31, 1987, FEDECCREDITO had conducted 3,765 training courses, seminars and conferences for 115,515 community members. These participants were to transfer their knowledge to 625,423 prospective program beneficiaries. A FEDECCREDITO official admitted that training efforts were directed to community members wanting to receive training for the purpose of attracting them to the program. The official went on to say that this training approach was never questioned by USAID/El Salvador and there had been virtually no feedback on training reports submitted to USAID/El Salvador.

FEDECCREDITO's approach, while possibly beneficial to the community as a whole, did not meet the major program objective of training credit beneficiaries to develop and upgrade their business operations.

Follow-up -- Neither FEDECCREDITO nor the credit agencies had an effective credit follow-up mechanism to ensure that loans were used for the purposes intended. For example, the audit found that 14 of the 115 loan beneficiaries interviewed had used the loan funds for other than agreed purposes. The responsible credit agencies were unaware of this situation. FEDECCREDITO blamed limited staff. When loans were not used for approved purposes, program objectives were not being achieved.

Loan Recovery -- FEDECCREDITO did not have an appropriate system to manage loan recoveries, despite recommendations detailed by consultants in 1983 and 1986. The latter report proposed solutions to the delinquency situation of the entire FEDECCREDITO system portfolio. The Monthly Loan Administration Report prepared by the agencies and delivered to FEDECCREDITO showed recoveries and delinquency rates collectively for the three funds under the Rural Community Development Program. However, the report did not provide this information separately for each fund nor an aging of delinquent accounts. Therefore, this report was of limited value for managing and monitoring the AID-supported small producer credit program.

Further, collection efforts by the agencies were inadequate to ensure an acceptable level of loan recoveries and delinquencies. The absence of adequate collection efforts can be measured by the fact that beneficiary credit files had not been updated to show current addresses, and program beneficiaries had seldom been visited by agency collectors. Other factors adversely affecting loan recoveries and delinquencies were inadequate verification of credit applications, adverse weather conditions, inadequate technical assistance and training, inadequate credit terms, and the civil conflict.

Consequently, the audit found that the number of small producer loan delinquencies was high. Although some questions existed about the specific rate of delinquency, the audit showed that between $1.2 million and $2.3 million, or between 16 and 25 percent of loans under the Rural Development Community Program were in arrears as of December 31, 1986. 1/

FEDECCREDITO had been reluctant to implement proffered technical assistance because of its desire to maintain tight control over the credit agencies. For instance, in September 1986 USAID/El Salvador discussed the need to initiate actions on the provision of technical assistance, but FEDECCREDITO put off implementation to a later time.

As a result, a proposed system of four model credit agencies had not been developed, improvements had not been disseminated to the other agencies and the institution building objective of the project had not been fully achieved.

The amended PACD to this project expired on September 30, 1986. The Mission and FEDECCREDITO had been attempting for over one year to negotiate an additional extention to the PACD but as of December 3, 1987 they have been unsuccessful in reaching an agreement. Furthermore, subsequent to the completion of the audit field work but prior to receipt of the Mission's comments on the draft report the terminal disbursement date (maximum obligation authority) expired. Consequently, the project funds are no longer available for use in this project.

Management Comments

> The Mission has decided to continue with the project and consequently cannot agree to the recommendation that the remaining funds be deobligated. The prolonged negotiation with FEDECCREDITO on the terms of the PIL was a legitimate and necessary step in a process whose final result was FEDECCREDITO's concurrence with the conditions laid out in the PIL. The suspension of disbursements has been used as leverage to bring about desired changes at FEDECCREDITO.
>
> Current redelegation of authority to the field No. 133 authorizes the Mission Director to extend the PACD for a period of two years beyond the last AID/W authorized PACD, which for this project was September 30, 1986. In addition, the Regional Legal Advisor, Gail Leece, has informed the Mission that the PACD may be extended at this time, even though more than a year has elapsed since September 30, 1986. As the project will

---

1/ The audit was unable to confirm an exact delinquency rate because of questionable data provided by FEDECCREDITO on the loan funds. The range was based on a reasonable interpretation of the supporting data and on rates reported in two recent external evaluations of FEDECCREDITO's operations.

continue, Mission requests that RIG issues a revised draft report citing those recommendations it feels are still pertinent. Original RAFs cited seven recommendations. Mission would appreciate the opportunity to work with RIG in developing the most effective wording of recommendations included in final audit report.

Office of Inspector General Comments

Notwithstanding the question whether or not the Project Activity Completion Date (PACD) can be extended after the PACD had been expired, the fact remains that the maximum obligation authority can not be ignored.

AID Handbook 3, Chapter 14, Sections 14D. 1.d. and 14D. 2.f. provides that the maximum obligation authority following the expiration of the PACD is nine (9) months for the project grant and loan agreements.

Since the grant and loan agreements established the maximum obligation authority to be no later than nine (9) months following the PACD, (section 3.3. (c) of the agreements) and the current PACD of those agreements is September 30, 1986, the authority to disburse funds expired on June 30, 1987 on both agreements. Consequently, Recommendation No. 1 remains as presented in the draft report and the project specific recommendations included in the original RAFs are no longer required.

2. The Lack of a Separate Accounting System Denied FEDECCREDITO Necessary Information

The grant and loan agreements required the borrower, in this case FEDECCREDITO, to maintain adequate books and records. FEDECCREDITO received money for loans from three separate funds, but did not separately account for the use of this money. As a result, FEDECCREDITO lacked timely and reliable information for decision making and for monitoring and reporting on AID- and GOE-provided funds. The Mission had not initially required separate accounting because it felt the necessary information could be derived from the current system. It has since provided equipment for a computerized accounting system, which will be completely operational by mid-1988.

Discussion

The Grant and Loan Agreements stated that the borrower was to "maintain or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, books and records relating to the Project and to this Agreement, adequate to show, without limitation, the receipt and use of goods and services acquired..." under the Program.

The audit found that FEDECCREDITO had not maintained separate accounting records to segregate program financial resources. Separate accounting was needed to maintain an accounting control of the three revolving funds operating under the program. The Grant and Loan Agreements required that adequate books and records be maintained to show without limitation, the receipt and use of goods and services acquired with AID funds. However, USAID/El Salvador failed to motivate FEDECCREDITO to meet this requirement because they felt the current accounting system was adequate.

The absence of detailed accounting records on the three funds hindered management's ability to adequately monitor and report on AID-provided resources. Information on the funds' capitalization and reflows was not readily available. An aging of program delinquent accounts could not be produced. Had FEDECCREDITO had this information, it could have better assisted the credit agencies in monitoring and managing a serious delinquency problem. Reinvestment of program reflows could not be accurately established; thus, the audit could not determine if reflow benefits were extended to additional urban and rural poor as envisioned by program designers. FEDECCREDITO indicated that reflows of $510,000 had been received during the first two months of 1987, of which $311,000 had been reinvested in the program as of March 31, 1987. However, separate accounts had not been established to show the capitalization and status of these funds. Finally, fund utilization could not be separately managed and monitored by FEDECCREDITO and USAID/El Salvador.

A new automated accounting system was designed by FEDECCREDITO (AID provided the computer equipment) and was being implemented incorporating 12 credit agencies, but will not be fully operational until 1988. According to FEDECCREDITO's Data Processing Department Chief, implementation of this new system began late in 1985 at four agencies and expanded with eight more in early 1987. The computerized accounting system will be fully operational in 12 agencies by August 1987 and in the whole credit system (FEDECCREDITO and its 61 agencies) by June 1988.

3. Decentralization of Credit Operations Would Speed the Delivery of Project Benefits

The audit found that unnecessary duplication existed in the project's credit operations because the Federation of Credit Institutions had not delegated responsibility for credit approval to its affiliated credit agencies. The project agreements provided that the Federation of Credit Institutions, to the maximum extent feasible, would decentralize its credit operations by assigning operational responsibility and management authority to its affiliated credit agencies so as to strengthen their institutional capabilities and to improve the program's efficiency. The Federation did not want to relinquish its control over the approval process because of concerns that its affiliated agencies would not adhere to the project's loan eligibility criteria. As a result, efforts were duplicated, loans were delayed and the institution-building aspect of the project was hampered.

Discussion

The audit found that FEDECCREDITO had not delegated responsibility to its member credit agencies for final loan approval under the Rural Community Development Program's three funds. In fact, the audit found that FEDECCREDITO was duplicating the efforts of its member credit agencies by reviewing, analyzing and granting final approval for credit applications regardless of the amount of credit involved and by establishing and maintaining duplicate credit files. The audit showed that FEDECCREDITO's review time consumed about 67 percent of the total time to process and approve a loan.
For the 155 loan applications reviewed, it took an average of 70 days from the date the application was received at the credit agency to the date it was approved, of which, 47 days were attributed to FEDECCREDITO's review process. The 13 credit agencies visited indicated that, with few exceptions, FEDECCREDITO approved all the credit applications that they had submitted.

On this basis, it appears that FEDECCREDITO's review process was excessive and that a more flexible policy including greater delegation of authority over credit operations to its member agencies was warranted.

The subject of delegating more responsibility to affiliated agencies has been discussed in other evaluations of the project. The most recent evaluation report by M.V. Consultores S.A. de C.V., dated March 1987, concluded that there existed a high degree of centralization of the financial and administrative operations of the system which was not allowing the credit agencies to grow, develop and expand their financial operations and productivity. The report went on to say that, notwithstanding this tight control, some credit agencies had demonstrated their technical capacity to manage efficiently the credit operations under their jurisdiction, and deserved to function with fewer operating restrictions. The report concluded that strengthening the credit agencies through more autonomy would also result in the strengthening of FEDECCREDITO, as the latter would be able to disperse or share the risk of the portfolio investment and commercial transactions. Similar conclusions were reached in 1983 and 1986 evaluations.

The audit found that these conclusions were shared by the credit agencies visited. Managers of these offices were of the opinion that decentralization of the system would result in more responsive services to the urban and rural poor, in increased and expanded credit operations, and would improve the economic, financial, and capital structure of the system. They also thought that greater autonomy would enhance the morale and credibility of local credit agencies.

The original project agreements provided that FEDECCREDITO was to decentralize its credit operations by delegating operational responsibility and management authority to its affiliated credit agencies. Specifically, Section 5 under Annex I to the Loan and Grant Agreements provided that FEDECCREDITO, to the maximum extent feasible, was to delegate responsibility and authority to the Board of Directors of the member agencies operating in the program.

The Federation had not delegated responsibility to its member agencies for final loan approval regardless of the loan amount or its experience with the member agency. According to the Federation's president, greater responsibility for credit operations had not been delegated to member agencies because the Federation would have less control over the funds and because of concerns that member agencies might not adhere to project eligibility criteria. However, as noted above, the Federation had also been reluctant to provide technical assistance and training to improve agency credit practices.

As a result, loan approvals were routinely delayed an average of one and a half months, which adversely affected the plans of some prospective borrowers. In some instances, loans were rejected by the borrowers as their original plans for the funds were no longer viable. In these cases, the time and effort involved with processing the loan was wasted and the potential reflow of interest on the loan was lost to the program.

B. Compliance and Internal Controls

1. Compliance

FEDECCREDITO was not in compliance with the Grant and Loan Agreements in that it had not yet instituted separate accounting systems for the three funds of the projects. It had not provided adequate training and assistance to the member agencies and had not moved to decentralize operations. Training was not confined to program beneficiaries. The member agencies violated the agreement in several credit practices. They did not always verify or take into consideration qualifications of beneficiaries or ensure that loans were used for project purposes. Other than conditions listed above, tested items were in compliance with applicable laws and regulations, and nothing else came to our attention that would indicate that untested items were not in compliance with applicable laws and regulations.

2. Internal Controls

Internal controls were lacking in three areas. Separate accounting systems were needed to control the three revolving funds. The project needed to institute a system to monitor and manage loan recoveries and to verify end-use of loans. Proposals for loans over $1,000 needed to be evaluated before loans were granted.

AUDIT OF USAID/EL SALVADOR
SMALL PRODUCER DEVELOPMENT
PROJECT NO. 519-0229 (B)

PART III - EXHIBITS AND APPENDICES

EXHIBIT 1
Page 1 of 1

SUMMARY OF FIELD VISITS

INFORMATION OBTAINED FROM CREDIT FILES

CAJAS	LOAN RECORDS REVIEWED	APPROVAL PROCESS: 1 MONTH	2-3 MONTHS	+3 MONTHS	VALUE 2/ OF LOANS REVIEWED	AMOUNT 2/ OF PORTFOLIO	AMOUNT 2/ IN ARREARS	PERCENTAGE IN ARREARS
CARA SUCIA	10	--	10	--	131.0	1,029.0	9.9	0.96
COJUTEPEQUE	16	1	7	8	93.5	2,738.0	575.2	21.01
SONSONATE	14	4	6	4	89.2	4,877.0	747.6	15.33
ZACATECOLUCA	12	1	6	5	171.3	6,013.0	2,489.7	41.41
USULUTAN	13	3	7	3	109.0	7,217.4	1,566.9	21.71
TONACATEPEQUE	10	--	4	6	57.1	1,811.9	802.3	44.28
ACAJUTLA	11	3	5	3	64.8	1,725.0	227.7	13.20
SAN MIGUEL	10	1	9	--	70.0	3,057.6	459.8	15.04
LA UNION	12	6	6	--	164.0	2,263.5	1,050.6	46.41
SANTIAGO NONUALCO	10	2	7	1	68.0	5,682.5	2.336.5	41.12
JUAYUA	13	2	8	3	80.0	796.6	216.2	27.14
CHALCHUAPA	13	5	8	--	101.0	2,134.4	511.9	23.98
IZALCO	11	3	6	2	64.5	2,902.1	1,441.2	49.66
	155	31	89	35	1,259.4	42,248.0	12,435.5	29.43

INFORMATION OBTAINED FROM BENEFICIARIES INTERVIEWED

CAJAS	BENEFICIARIES INTERVIEWED	PROGRAM 3/: DFP	PEMER	FERN	FEASIBILITY STUDY OR PROFILE	BENEFICIARIES WITH ASSETS OVER C.100,000	T.A. PROVIDED	TRAINING PROVIDED	IN ARREARS	MAIN ACTIVITY NOT RELATED TO LOAN	FUND USED NOT FOR PURPOSE
CARA SUCIA	10	10	--	--	5	1	1	--	4	--	--
COJUTEPEQUE	10	7	2	1	2	1	--	--	5	1	1
SONSONATE	10	5	5	--	6	--	3	2	8	4	1
ZACATECOLUCA	10	4	3	3	2	1	1	--	6	--	--
USULUTAN	10	6	2	2	--	3	--	--	4	1	--
TONACATEPEQUE	10	5	5	--	1	1	--	--	4	1	2
ACAJUTLA	10	6	4	--	2	1	2	--	4	3	3
SAN MIGUEL	4	2	1	1	--	2	--	--	--	--	--
LA UNION	8	8	--	--	--	2	--	--	6	5	4
SANTIAGO NONUALCO	6	4	2	--	1	1	1	--	1	1	1
JUAYUA	12	9	3	--	1	--	--	--	6	1	1
CHALCHUAPA	9	7	2	--	1	1	1	--	2	2	1
IZALCO	6	6	--	--	--	2	--	--	4	--	--
	115	79	29	7	21	16 1/	9	2	54	19	14

EXPLANATORY NOTES

1/ These 16 loans were funded as follows: DFP-11; FERN-3; and PEMER-2.
2/ Amount in thousands of Colones.
3/ DFP = Small Producer Development Credit Fund
FERN = Special Fund for National Reconstruction
PEMER = Special Program for Rural Micro-Enterprises

SMALL PRODUCER DEVELOPMENT EVALUATIONS, STUDIES AND AUDITS CONDUCTED ON THIS PROGRAM

DATE OF REPORT	EVALUATOR'S NAME	DESCRIPTION OF STUDY
March, 1987	M.V. Consultores, S.A. de C.V.	Financial-Economic Study of the Rural Credit System
April, 1987	Alfredo Chedraui	Audit of FEDECCREDITO 1986 Financial Statements
February, 1986	Triton Corporation	Evaluation of FEDECCREDITO New Computer System
March, 1986	Robert R. Nathan & Associates	Technical Assistance Plan to Strengthen the Agency System
April, 1986	Alfredo Chedraui	Audit of FEDECCREDITO 1985 Financial Statements
May, 1986	Management Development & Consultancy	Review of Technical Assistance Activities of the Rural Credit System
July, 1986	Robert R. Nathan & Associates	FEDECCREDITO Credit Policies
August, 1986	Robert R. Nathan & Associates	Short-Term Plan for Institutional Strengthening and Technical Assistance
September, 1986	Robert R. Nathan & Associates	Short-Term Plan for Institutional Strengthening and Technical Assistance
September, 1986	Robert R. Nathan & Associates	Computer System Update
September, 1986	Robert R. Nathan & Associates	Summary of the Rural Credit System's Financial Situation
October, 1986	Rene O. Figueroa	Administrative Review of DPP Operations

DATE OF REPORT	EVALUATOR'S NAME	DESCRIPTION OF STUDY
December, 1986	Oficina Agraria de Investigacion y Consultoria (AINCO)	Evaluation of the Small Producer Development Program and Its Socio-Economic Impact
August, 1985	Esquivel & Esquivel Asociados	Audits of FEDECCREDITO Requests to AID for Reimbursement for Small Producer Credits Made
September, 1985	Esquivel & Esquivel Asociados	Audits of FEDECCREDITO Requests to AID for Reimbursement for Small Producer Credits Made
August, 1983	Carlos Dextre	Management Assessment
September, 1983	Castellanos, Cea, Campos y Cia.	Internal Control Review

ACTION: RIG-3 INFO: DCM ECON/5

VZCZCTGO3ØØ 03-DEC-87 TOR: 17:1Ø
OO RUEHTG CN: 26422
DE RUEHSN #5841 3371710 CHRG: AID
ZNR UUUUU ZZH DIST: RIG
O Ø31710Z DEC 87 ADD:
FM AMEMBASSY SAN SALVADOR
TO RUEHTG/AMEMBASSY TEGUCIGALPA IMMEDIATE 1819
RUEHC/SECSTATE WASHDC 5937
BT
UNCLAS SAN SALVADOR 15841

AIDAC

FOR CCINAGE N. GOTHARD, JR. RIG/A/T

E.O. 12356: N/A
SUBJECT: DRAFT AUDIT REPORT OF USAID/EL SALVADOR SMALL PRODUCER DEVELOPMENT PROJECT NO. 519-Ø229(B)

1. THE MISSION APPRECIATES THE WORK PERFORMED BY THE RIG IN RESPONSE TO OUR REQUEST FOR AN AUDIT OF THIS PROJECT.

2. THE MISSION HAS DECIDED TO CONTINUE WITH THE PROJECT AND CONSEQUENTLY CANNOT AGREE TO THE RECOMMENDATION THAT THE REMAINING FUNDS BE DEOBLIGATED. THE PROLONGED NEGOTIATION WITH FEDECCREDITO ON THE TERMS OF THE PIL WAS A LEGITIMATE AND NECESSARY STEP IN A PROCESS WHOSE FINAL RESULT WAS FEDECCREDITO'S CONCURRENCE WITH THE CONDITIONS LAID OUT IN THE PIL. THE SUSPENSION OF DISBURSEMENTS HAS BEEN USED AS LEVERAGE TO BRING ABOUT DESIRED CHANGES AT FEDECCREDITO.

3. CURRENT REDELEGATION OF AUTHORITY TO THE FIELD NO. 133 AUTHORIZES THE MISSION DIRECTOR TO EXTEND THE PACD FOR A PERIOD OF TWO YEARS BEYOND THE LAST AID/W AUTHORIZED PACD, WHICH FOR THIS PROJECT WAS SEPTEMBER 3Ø, 1986. IN ADDITION, THE REGIONAL LEGAL ADVISOR, GAIL LEECE, HAS INFORMED THE MISSION THAT THE PACD MAY BE EXTENDED AT THIS TIME, EVEN THOUGH MORE THAN A YEAR HAS ELAPSED SINCE SEPTEMBER 3Ø, 1986.
4. AS THE PROJECT WILL CONTINUE, MISSION REQUESTS THAT RIG ISSUES A REVISED DRAFT REPORT CITING THOSE RECOMMENDATIONS IT FEELS ARE STILL PERTINENT. ORIGINAL RAFS CITED SEVEN RECOMMENDATIONS. MISSION WOULD APPRECIATE THE OPPORTUNITY TO WORK WITH RIG IN DEVELOPING.THE MOST EFFECTIVE WORDING OF RECOMMENDATIONS INCLUDED IN FINAL AUDIT REPORT.
CORR
BT
#5841

NNNN

RECEIVED

REPORT DISTRIBUTION

	No. of Copies
Director, USAID/ES	5
AA/LAC	2
LAC/CAP/ES	1
LAC/CONT	1
LAC/DP	1
LAC/DR	1
LAC/GC	1
LAC/RLAs	1
GAO Panama	1
AA/XA	2
XA/PR	1
LEG	1
GC	1
AA/M	1
M/FM/ASD	3
PPC/CDIE	2
IG	1
D/IG	1
IG/PPO	2
IG/LC	1
IG/EMS/C&R	12
IG/I	1
RIG/I/T	1
Other RIG/As	1