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REPORT OF AUDIT

**ECONOMIC DEVELOPMENT LOANS
(PROJECT NO. 492-14-III)**

**ADMINISTERED BY THE
DEVELOPMENT BANK OF THE PHILIPPINES**

1 October 1965 to 30 June 1967

Audit Report No. 68-7

Date Issued 23 JANUARY 1968

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OFFICE OF THE CONTROLLER
UNITED STATES AID MISSION TO THE PHILIPPINES
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

REPORT OF AUDIT

ECONOMIC DEVELOPMENT LOANS

PROJECT NO. 492-14-111

ADMINISTERED BY THE

DEVELOPMENT BANK OF THE PHILIPPINES

1 October 1965 to 30 June 1967

CENTRAL RESOURCE LIBRARY
USAID/MANILA

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REPORT OF AUDIT

ECONOMIC DEVELOPMENT LOANS PROJECT NO. 492-14-111 ADMINISTERED BY THE DEVELOPMENT BANK OF THE PHILIPPINES

1 October 1965 to 30 June 1967

SCOPE OF AUDIT

Scope of Examination: We performed an audit of the Economic Development Loans Project No. 492-14-111 administered by the Development Bank of the Philippines (DBP). The purpose of our audit was to determine DBP's effectiveness in administering supervised credit in the implementation of the project activities, the degree of DBP's compliance with the terms of the project agreement, and to identify any problem areas that required corrective action. We examined appropriate project documents including USAID/P and DELP records and extended our audit coverage to the Cabanatuan Branch Office, one of the nine DBP branch offices involved in this economic development loan program.

Audit Period: We performed our audit of the Economic Development Loan Project during the period June through September 1967 and covered the project activities during 1 October 1965 through 30 June 1967. An exit conference was held with personnel of the Office of Rural Development and Office of Industrial Development, USAID/P on 18 October 1967.

BACKGROUND INFORMATION

The Economic Development Loans Project No. 492-14-111 was approved in January 1959 for the purpose of extending small agricultural loans to the farmers under the administration of the Development Bank of the Philippines (DBP). During the period 2 July 1959 to 3 February 1960, a total of P14,934,428 (pesos) were released to the DBP in the form of a loan through the National Economic Council (NEC). These funds released by the NEC were the local currency proceeds of AID Loans ICAX 92-2 P5,000,000 (pesos), Section 402 funds, and ICAX 92-3 P9,934,428 (pesos), PL 480 funds, to the NEC by the USAID. Loan payments under both ICAX 92-2 and ICAX 92-3 by the Republic of the Philippines (RP) to the USAID are current and the annual interest rate for the two ICAX loans is 3 per cent per annum when payments are made in United States dollars and 4 per cent per annum when payments are made in local currency. The P14,934,428 (pesos) are payable to the NEC by the DBP in the following manner: P5,000,000 (pesos) payable in 73 semi-annual payments with interest at the rate of 4 per cent per annum. The first semiannual payment was due 1 May 1962 with the final payment being due 1 May 1998. The P9,934,428 (pesos) are payable in 33 semiannual payments with interest at the rate of 4 per cent per annum due 1 September 1963, with the final payment being due 1 September 1979. The DBP and NEC are current on their payments of the loans. The status of the loans as of 30 June 1967 follows:

	<u>PROAG dated</u> <u>8 January 1959</u>	<u>PROAG dated</u> <u>26 June 1959</u>	<u>Total</u>
Amount of Loan	P5,000,000	P9,934,428	P14,934,428
Payments on Principal	<u>452,802</u>	<u>585,622</u>	<u>1,038,424</u>
Balance	<u>P4,547,198</u>	<u>P9,348,806</u>	<u>P13,896,004</u>
Payments on Interest	<u>P1,156,068</u>	<u>P1,761,210</u>	<u>P 2,917,278</u>

Under the terms of the project agreement the DBP shall use the loan fund to extend small agricultural loans to farmers under their normal credit plan. It further stipulates that the following criteria should be observed by the DBP in extending the loan funds to the borrowers:

- a. Directly increasing agricultural production.
- b. Minimizing factors that cause crop failure.
- c. Encouraging farmers to use tested farm management practices.
- d. Increasing farm income of the farmers.
- e. Promoting diversified agriculture in the country.

The Rehabilitation Finance Corporation (RFC) now the DBP, a government controlled corporation was created in 1946 to provide credit facilities for the reconstruction of property damaged by the war and to assist in the development and expansion of the Philippine economy. The DBP in addition to its Manila Office has created 18 field branches to assist in administering the bank's loan program. During the period 2 January 1947 to 30 June 1966, the DBP has on its own granted approximately P2.7 billion (pesos) in various forms of loans to 156,409 borrowers.

SUMMARY

Based on the findings and recommendations set forth in detail in other sections of this report, the administration of the Economic Development Loans Project by the Development Bank of the Philippines (DBP) is considered inadequate. While the DBP has kept its loan payments current to the National Economic Council (NEC), the project implementation is unsatisfactory since the DBP has failed to extend adequate guidance to the borrowers under the required supervised credit plan. This condition has resulted in numerous delinquent loan accounts and in foreclosures on loans extended to the farmers under those accounts classified by the DBP as USAID-NEC loan funds. We recognize that some of our statistical data used in measuring effects of deficiencies may be incorrect as they were based on DBP records, which in our opinion, contained errors resulting from the arbitrary classification of P30 million (pesos) of loans made from USAID-NEC funds. However, these statistics indicate deficien-

cies of such significance as to offer no assurance that such funds have been properly utilized. The following paragraphs summarize the conditions observed during our audit.

a. Arbitrary Classification of Borrowers Under the USAID-NEC Loan Fund - Recommendation No. 1: The DBP should comply with the terms of the project agreement to accurately identify the borrowers under this program and to maintain separate accounting records to permit an evaluation of program's success. During the initial years of the program DBP did not maintain separate records and on 30 September 1961 arbitrarily assigned certain outstanding loans to the USAID-NEC fund. This action has resulted in numerous errors in the classification of the borrowers who have and are participating in this program.

b. Inadequate Supervised Credit Assistance by the DBP - Recommendation No. 2: The DBP should be required, in accordance with the terms of the project agreement, to implement a supervised credit program for the administration of small agricultural loans granted under the USAID-NEC loan fund. The failure to implement a supervised credit program has resulted in numerous delinquent accounts and in foreclosure actions.

c. Delinquent Accounts - Recommendation No. 3: There is a need for the DBP to exercise better control over delinquent loans and to review the possibility of refinancing certain loans rather than initiating foreclosure action. The number of delinquent loans has steadily increased during the past years, to the point that as of 31 December 1966, the DBP records reflect that of a total of P9,938,642 (pesos) loans outstanding identified as USAID-NEC loans, P4,184,781 (pesos) were delinquent.

d. Inadequate Reporting System by the DBP Branch Offices - Recommendation No. 4: There is a need for the DBP to enforce its reporting requirements from branch offices on the status of outstanding loans. As a result of our prior audit report, the Chairman of DBP issued a directive requiring each office to submit semiannual reports on the status of outstanding loans. The DBP branch offices, however, at the time of our audit had not complied with this directive. The failure of branch offices to submit reports on outstanding loans prevents the DBP Headquarters from having the required information to effectively manage this program.

PRIOR AUDIT REPORT

Audit Report No. 66-18, dated 17 March 1966, contained two recommendations relating to deficiencies concerning the submission of loan status reports by the bank branch offices. Since these conditions have not been corrected, we have included appropriate recommendations in this report for action by the Development Bank of the Philippines.

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STATEMENTS OF CONDITIONS AND RECOMMENDATIONS

Arbitrary Classification of Borrowers Under the USAID-NEC Loan Fund

There is a need for the Development Bank of the Philippines (DBP) to accurately identify the borrowers under the USAID-NEC loan fund. Our examination disclosed that the loan funds have been commingled with DBP funds and DBP has not maintained the separate accounting records as required under the terms of the project agreement. As a result of this condition it is extremely difficult and time consuming to identify the borrowers who have received financial assistance and to accurately determine the progress of the project financed under the loan.

We were informed by the DBP officials that during the early phase of the loan separate accounting of the loan transactions was not maintained. The DBP in 1961 recognized that it had failed to maintain separate records of the loan transactions and arbitrarily classified, without the concurrence of USAID/P, all small agricultural loans below P5,000 (pesos) and granted up to 30 September 1961, as those loans being extended under USAID-NEC funds. The total amount of loans falling in this category as of 30 September 1961, amounted to P30,408,833 (pesos), which was grossly overstated for loans extended under the USAID-NEC loan funds. It is not possible that a P14.9 million (pesos) USAID-NEC loan fund would revolve and could extend, loans up to P30.4 million (pesos) within a two-year period, in view of the condition that a large percentage of the maturity dates for small agricultural loans were over a ten-year period. The P30,408,833 (pesos) classified as loans granted under the USAID-NEC fund did not represent the results of loan operations as of 30 September 1961. The following schedule sets forth the arbitrary classification of the USAID-NEC fund as of 30 September 1961:

Small Agricultural Loans Approved

Under USAID-NEC Funds

From 2 January 1959 to 30 September 1961

	<u>Amount Approved</u>	<u>Amount Released</u>	<u>Repayments</u>		<u>Principal Balance</u>
			<u>Principal</u>	<u>Interest</u>	
Head Office	P 7,115,397	P 4,460,602	P 328,364	P157,739	P 4,132,238
Branches	<u>28,171,349</u>	<u>25,943,231</u>	<u>2,108,211</u>	<u>799,798</u>	<u>23,840,020</u>
	<u>P35,286,746</u>	<u>P30,408,833</u>	<u>P2,436,575</u>	<u>P957,537</u>	<u>P27,972,258</u>

The errors in the accounting records of the DBP resulting from this arbitrary classification of loans, raise questions as to the accuracy of the DBP records for USAID-NEC outstanding loans as of the date of our audit. However,

as this was the only data available and it was not possible for the auditor to reconstruct the loan records, we have reported on the status of the loan fund as reflected on the DBP records at the time of our audit.

Recommendation No. 1: It is recommended that the Development Bank of the Philippines:

- a. Accurately classify the loans financed under the USAID-NEC fund.
- b. Maintain separate records for the USAID-NEC fund as required under the project agreement in order that all loans financed under this program may be properly identified.

Action: National Economic Council/Development Bank of the Philippines through the Office of Industrial Development, USAID/P

Follow-up: Audit Branch, USAID/P

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Inadequate Supervised Credit Assistance by the DBP

The failure of the Development Bank of the Philippines (DBP) to implement the provisions of the Project Agreement has resulted in the granting of loans to farmers without the required supervised credit assistance. This condition has resulted in a high percentage of delinquent loans and in foreclosure actions.

Under the terms of the Project Agreement the DBP was required to implement a program of supervised credit in granting and monitoring small agricultural loans to farmers. USAID-NEC funds totaling 14,934,428 (pesos) were made available to the DBP during the period 2 July 1959 through 3 February 1960, however, the DBP did not publish its procedures for the supervised credit program until 1962, a date subsequent to granting the loan funds to borrowers. The DBP has attributed the nonavailability of qualified agricultural credit supervisors as the reason for its failure to implement the supervised credit program. Available information indicates that the DBP trained only 24 agricultural credit supervisors during the period 1961 to 1967, of which 20 were employed by six of the 18 branch offices at the time of our audit. Considering that the DBP approves approximately 10,000 agricultural loans per year, DBP officials admitted that they cannot effectively implement the supervised credit program with only 20 personnel. The DBP officials further stated that the agricultural credit supervisors had been assigned to supervise only large agricultural loans normally in amounts exceeding P50,000 (pesos). To aggravate this condition, credit supervisors are presently performing functions not directly related to the supervised credit program, in that much of their time is devoted to the verification of loans, reinspection of properties for reappraisal, verification of amortizations and foreclosures which according to them are types of work normally handled by the loan appraisers and credit examiners.

We performed a review of the USAID-NEC loans outstanding on the records of the Cabanatuan Branch Office. We recognize that the arbitrary classification of P30 million (pesos) of loans, as discussed in Recommendation No. 1, has resulted in errors in these records, however, these were the only data available at the Branch Office that could be used as a yardstick to measure the progress of the loan program. In our examination at the Cabanatuan Branch Office we noted that as of 30 June 1967, there were 5,963 agricultural loans outstanding of which only 52 loans or less than 1 per cent were under the supervised credit plan, however, none of the 52 loans were classified to the USAID-NEC loan fund. We were informed by the Cabanatuan officials that the first agricultural credit supervisors arrived during November 1964, which was almost four years after the granting of USAID-NEC loans. With only 20 agricultural credit supervisors available for 18 branch offices we would predict that similar conditions exist in other branch offices.

Recommendation No. 2: It is recommended that the Development Bank of the Philippines be required to comply with the terms of the Project Agreement, requiring the use of a supervised credit program to monitor the utilization of funds made available under this project.

Action: National Economic Council/Development Bank of the Philippines
through the Office of Industrial Development, USAID/P

Follow-up: Audit Branch, USAID/P

Delinquent Accounts

In an attempt to review the accomplishments under the USAID loan, we reviewed the records of the Development Bank of the Philippines (DBP) to determine the utilization and status of such funds. We recognize that the arbitrary classification of P30 million (pesos) of loans under this project, as discussed in Recommendation No. 1, has resulted in errors in these records. However, as these were the only data available they were used as a yardstick to measure the possible accomplishments under the loan program. At the time of our audit the DBP records reflected that the P30 million (pesos) of USAID-NEC loans had been reduced to P9 million (pesos).

The records of the DBP reflected the numerous small agricultural loans, classified by the DBP as USAID-NEC loan, were delinquent in their loan repayments at the time of our audit. Our previous report on this program revealed that the delinquency of outstanding loans had been increasing since 1960 and that unless corrective action was initiated serious problems would result under this program. For example, our review at 30 June 1967 of the status of small agricultural loans made by the Headquarters Office of the DBP disclosed that 399 borrowers or, 69 per cent of the 577 outstanding loans, were delinquent in their amortization payments. Furthermore, of the 399 delinquent borrowers 141 or 35 per cent of the borrowers were between four to six years behind in their payments and 31 delinquent accounts totaling P37,834 (pesos) were under foreclosure action.

Our review of the Cabanatuan Branch Office disclosed that as of 30 June 1967, 638 borrowers or, 60 per cent of the 1,068 outstanding loans, were delinquent and 119 accounts were under foreclosure action. The following schedule sets forth the details of loan delinquency as reflected on the records of the DBP Headquarters and the Cabanatuan Office as of 30 June 1967:

<u>Aging of Delinquent Accounts</u>	<u>Classification As Being USAID-NEC Loans</u>			
	<u>DBP</u>		<u>DBP</u>	
	<u>Manila</u>	<u>Per Cent</u>	<u>Cabanatuan</u>	<u>Per Cent</u>
1 Year	137	34	182	28
2 Years	66	17	190	30
3 Years	55	14	246	39
4 Years	51	13	18	3
5 Years	41	10	2	-
6 Years	49	12	-	-
	<u>399</u>	<u>100%</u>	<u>638</u>	<u>100%</u>

The above condition, however, is not restricted to the DBP Headquarters and the Cabanatuan Branch Office but prevails in all of the nine branches administering the USAID-NEC fund. Based on the latest available report at the DBP Headquarters, the status of delinquency under the USAID-NEC loan fund as of 31 December 1966 was as follows:

	<u>Loan Balances</u> <u>As of 31 December 1966</u>	<u>Past Due</u> <u>Amortizations</u>	<u>Percentage of</u> <u>Delinquency</u>
1. Head Office	P1,018,115	P 360,075	35
2. Cotabato	1,525,223	997,760	65
3. Davao	899,585	246,009	27
4. Tacloban	691,413	214,018	31
5. Isabela	1,697,934	769,102	45
6. Naga	1,071,521	301,631	28
7. General Santos	1,456,762	895,735	61
8. Cagayan de Oro	194,487	36,086	19
9. Cabanatuan	997,172	364,365	37
10. Bacolod	<u>386,430</u>	<u>Not Available</u>	
	<u>P9,938,642</u>	<u>P4,184,781</u>	42%

Recommendation No. 3: It is recommended that the Development Bank of the Philippines:

a. Initiate additional follow-up action for the collection of the delinquent accounts, and

b. Conduct a survey on the status of delinquent accounts and determine which farmers warrant assistance through refinancing of the delinquent loans under this project.

Action: National Economic Council/Development Bank of the Philippines through the Office of Industrial Development, USAID/P

Follow-up: Audit Branch, USAID/P

Inadequate Reporting System by the DBP Branch Offices

In our previous review of this program we noted that delinquent accounts were outstanding for periods up to six years, a condition resulting from inadequate supervision and control by the Development Bank of the Philippines (DBP). Based on our recommendation the DBP Chairman on 9 June 1966, directed the departments and branch offices to submit effective 30 June 1966, a semi-annual report with details on the outstanding loans and past due amortizations. These reports would enable the DBP to provide control and guidance over the collection of loans by department and branch offices. Our current audit revealed that one of the nine branch offices has not submitted the required report for the period ending 31 December 1966, and that eight of the nine branch offices have not submitted the reports ending 30 June 1967. In view of the large number of branch offices which have not submitted the required reports, we consider that the reporting system under this program continues to be unsatisfactory and, thereby, preventing the DBP Headquarters from having the information required to effectively manage this program.

Recommendation No. 4: It is recommended that the Development Bank of the Philippines:

a. Require its field branches to submit promptly the semiannual schedules of outstanding loans and past due amortizations.

b. Prepare and submit to the NEC and USAID/P on a semiannual basis, a consolidated report by branch office of outstanding USAID/P-NEC loans showing:

- (1) Total amount released;
- (2) Total balances outstanding; and
- (3) Total past due amortizations.

Action: National Economic Council/Development Bank of the Philippines through the Office of Industrial Development, USAID/P

Follow-up: Audit Branch, USAID/P

ECONOMIC DEVELOPMENT LOANS
PROJECT NO. 492-14-111
ADMINISTERED BY THE
DEVELOPMENT BANK OF THE PHILIPPINES

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