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Auditor General

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AUDIT REPORT
RURAL ENTERPRISES DEVELOPMENT
LOAN No. 527-W-057
USAID/PERU

Audit Report Number 1-527-79-13
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Area Auditor General Latin America
Agency for International Development

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I INTRODUCTION

The Office of the Area Auditor General for Latin America (AAG/LA) has made an audit of Rural Enterprises Development Loan No. 527-W-057 administered by the USAID Mission to Peru. The purpose of the audit was to observe progress made towards project objectives and to determine if the project is being implemented in accordance with the terms and conditions of the Loan Agreement.

II BACKGROUND AND SCOPE

Loan No. 527-W-057 for \$10 million was signed on November 25, 1974. Its purpose as stated in the Loan Agreement as amended, is to provide funds to the Government of Peru (GOP) for a program to assist new and existing rural enterprises in Peru by making available an integrated program of credit and technical assistance to such enterprises. Specifically, the program is designed to facilitate the availability of credit and technical assistance to those enterprises and organizations which have not previously received or had normal access to credit on reasonable terms and conditions. Projects financed under the program are designed to contribute to:

1. the development and strengthening of rural enterprises;
2. the creation of employment;
3. the generation and distribution of income; and
4. a higher level of economic activity in several of the poorer regions of Peru.

Up to \$1.7 million of the loan is available to finance projects in the area affected by the earthquake of May 31, 1970 (Affected Area). Up to \$8.3 million of the loan is available to finance projects in the departments of Cuzco, Puno, Junin, Ayacucho, Apurimac, Cajamarca, Huanuco, and Huancavelica (Rural Departments). Under the provision of the Loan Agreement, the GOP is to contribute \$6.2 million to the program.

The GOP designated Organismo Regional de Desarrollo del Norte Centro (ORDENOR-CENTRO) as the implementing agency for projects to be carried out in the Affected Area. Banco Industrial de Peru (BIP) is the GOP designated implementing agency for projects carried out in the Rural Departments.

The financial status of the loan at March 31, 1979 was:

	<u>ORDENOR- CENTRO</u>	<u>BIP</u>	<u>TOTAL</u>
Loan Amount	\$1,700,000	\$8,300,000	\$10,000,000
Accrued Expenditures	<u>1,526,754</u>	<u>5,773,719</u>	<u>7,300,473</u>
Balance	<u>\$ 173,246</u>	<u>\$2,526,281</u>	<u>\$ 2,699,527</u>

The audit included examination of project files, discussions with project personnel, visits to implementing agencies, sample field observations of project sites and such other procedures considered necessary to meet the objectives of the audit. The period of audit was from June 30, 1976 (prior AAG/LA survey cut-off date) through March 31, 1979. There are no outstanding audit recommendations contained in prior AAG/LA Survey Report No. 1-527-77-8 dated November 8, 1976.

III SUMMARY

Rural Departments

Under this program, 3,249 sub-loans had been made to rural enterprises at December 31, 1978. These sub-loans have resulted in the creation of additional employment, new businesses and expansion of existing businesses. The terminal commitment (October 31, 1979) and disbursement (April 30, 1980) dates were extended due to the substantial devaluation of the Peruvian Sol which generated more local currency than had originally been planned. The unexpended balance of loan funds is expected to be utilized by the end of CY 1979. Because of the success of the program, the USAID executed with the GOP a follow-on loan to expand the program. Our review disclosed several deficiencies, a summary of which follows. Detail appear in Part IV, Findings and Recommendations, Section A.

Peru's implementing agency for Rural Departments has not submitted the program reports required by implementation letters.

Accounting and reporting on the use of sub-loan repayments have not been done by the implementing agency as required by the loan agreement.

The required counterpart contribution for U.S. dollar costs of goods and services financed with loan funds has not been made by the GOP.

Affected Area

The program under the Affected Area will be completed July 1979 and allocated loan funds for this purpose utilized when the last of the 36 sub-loan projects will have been completed. Loan objectives of strengthening enterprises and creating additional employment have been met by projects in the Affected Area financed with loan funds. Details about this program appear in Part IV, Findings and Recommendations, Section B.

IV FINDINGS AND RECOMMENDATIONS

A. Rural Departments

The Loan Agreement executed November 25, 1974, provided \$6 million for assistance to enterprises within the rural departments of Cuzco, Puno, Junin, and Ayacucho. Amendment No. 1 to the Loan Agreement executed on August 3, 1977, increased loan funds available for rural enterprises to \$8.3 million and added the rural departments of Apurimac, Cajamarca, Huanuco, and Huancavelica. The financial status of loan funds allocated for the Rural Departments at March 31, 1979 was:

	<u>Sub-loans</u>	<u>Technical Assistance</u>	<u>Total</u>
Funds Committed	\$7,800,000	\$500,000	\$8,300,000
Accrued Expenditures	<u>5,563,478</u>	<u>210,241</u>	<u>5,773,719</u>
Balance	<u>\$2,236,522</u>	<u>\$289,759</u>	<u>\$2,526,281</u>

Under the terms of the Loan Agreement, the GOP is to contribute to the project the equivalent of \$5.2 million for sub-loans and \$.5 million in support costs. At March 31, 1979, GOP counterpart contribution was the equivalent of U.S.\$3.4 million. In addition, the GOP has financed the operating costs to administer the program at a cost of U.S.\$.9 million per year.

Because of the widely fluctuating exchange rate of the Peruvian Sol, loan expenditures have not been as rapid as planned. The rate of exchange has varied from S/. 43.38 to \$1.00, when the initial loan disbursement was made, to S/. 212.00 to \$1.00, when the most recent loan disbursement was made to BIP. As a result of the substantial amount of Peruvian Soles generated by loan disbursements, BIP could not liquidate funds allocated to the Rural Department by the original terminal commitment date (TCD) of January 31, 1979 and the terminal disbursement date (TDD) of July 31, 1979. The USAID in conjunction with BIP made projections based on a shadow exchange rate of S/. 200 to \$1.00 and concluded that loan funds could be fully utilized if the TCD and TDD were extended by one year. On December 4, 1978, the USAID with AID/W authority, extended the loan TCD to October 31, 1979 and the loan TDD to April 30, 1980.

Loan funds allocated for technical assistance have been used to finance costs of processing sub-loans for feasibility studies, reviews, administration and vehicles. The balance of unextended technical assistance funds are to be used to purchase equipment to upgrade BIP's record keeping capacity and vehicles for BIP branch offices in order that they can increase their ability to promote sub-loans.

The total value of the outstanding sub-loan portfolio at December 31, 1978 was S/. 813,145,639. A summary of number of sub-loans by type of business at December 31, 1978 was:

Artisan	858
Industry	1,907
Services	339
Tourism	39
Commerce	41
Agricultural	63
Fisheries	<u>2</u>
Total	<u>3,249</u>

Number of sub-loans by amount was:

	<u>US\$</u>
Up to 500	1,077
500 to 700	627
700 to 3,000	1,060
3,000 to 5,000	234
over 5,000	<u>251</u>
Total	<u>3,249</u>

Studies made by BIP on a sampling of sub-loan projects disclosed that the projects have been successful. Thirty-five percent of sub-loans made accounted for the creation of new businesses with the remaining 65 percent used to expand existing businesses. The BIP study disclosed that on an average each sub-loan created four additional jobs at an average cost of \$1,975 per job. A study made in June and July 1978 by a USAID-funded contractor on the social impact of project sub-loans concluded that the program has been beneficial in the regions that it is operating and has demonstrated its ability to generate employment. We visited 21 projects financed with sub-loans and found these projects met the criteria and objectives of the Loan Agreement and had created additional jobs. As a result of the success of the project, the USAID and the GOP on May 25, 1979, executed a Rural Enterprise II follow-on loan for \$8 million in order that the project can be expanded to other rural departments.

1. Reports

BIP has not been submitting periodic reports on program activity on a regular basis or in the format required by the Loan Agreement terms.

Implementation Letter No. 4, June 18, 1975, requires the Bank to submit seven types of reports to the Mission:

- a. Monthly Financial Report
- b. Quarterly Loan Portfolio Statement
- c. Quarterly Activity Report
- d. Annual Financial Report
- e. Annual Audit Report
- f. Quarterly Shipping Report
- g. Annual Report of Use of Sub-loan Repayments.

With the exception of the Annual Financial Report and Annual Audit Report, BIP has not been submitting these reports to the USAID.

Implementation Letter No. 4 also requires that certain information be sent with requests for reimbursement. This information is to include details on each sub-loan made during the month, giving the location, participating financial institution if any, name of sub-borrower, purpose of sub-loan, value of sub-loan, sub-borrower equity participation, and sub-loan terms and conditions. A sample of reimbursement vouchers showed the branch bank making the sub-loan, name of sub-borrower, and amount disbursed to sub-borrower. Other required information was lacking.

The USAID has made requests to BIP for these reports. However, BIP has been unable to comply with the requests because its current computer system does not have the capacity to produce the needed information. Manual compilation of the data is not practical because of the large number of sub-loans under the program. The present BIP computer system will have to be expanded in order to produce the necessary program data.

Technical assistance loan funds have been programmed to finance the expansion of the computer system. Various BIP divisions are currently working on the development of expanding the computer system. However, it is estimated that it will be one year before the new system is fully operational. Loan 057 funds are expected to be fully disbursed by the end of calendar year 1979 and at that time the follow-on loan is expected to be operational. For this reason it is important that the reporting mechanism be operational as soon as possible, and thus the USAID should explore with BIP possible ways of expediting the expansions of the computer system.

Recommendation No. 1

USAID should explore with BIP ways of expediting the expansion of the BIP computer system to provide required reports.

2. Use of Sub-loan Repayments

BIP has not complied with the Loan Agreement terms regarding use of sub-loan repayments.

Section 5.04 of the Loan Agreement provides that:

"Except as AID may otherwise agree in writing, all repayments of principal and all payments of interest derived from Project sub-loans will be deposited in the Fund and used throughout the repayment period of the Loan for activities associated with the development of rural enterprises."

Implementation Letter No. 4 requests that BIP submit annual reports to the USAID showing that all repayments of principal and interest have been deposited in the Fund for use in activities associated with rural enterprises development. As mentioned in Section I, Reports, BIP has not submitted to the USAID any report concerning the use of repayments.

BIP officials informed us that no separate accounting is made for repayments of sub-loans under the program and that repayments are credited to the general fund. In order to ensure that the borrower is complying with Section 5.04 of the Loan Agreement, the USAID should request BIP to make an accounting of repayments of sub-loans under the program and to prepare a report on their use.

Recommendation No. 2

USAID should request BIP to make an accounting of repayments of sub-loans under the program, and to report on what the repayments are used for.

3. U.S. Dollar Costs of Goods and Services

BIP has not made its required counterpart contribution to the program for loan-disbursed U.S. dollar costs of goods and services for sub-loan projects. At March 31, 1979, loan funds disbursed for U.S. dollar costs of goods and services for sub-loan projects was \$421,809.

Attachment J of Implementation Letter No. 4 provides that AID will reimburse from loan funds 60 percent of the total of project disbursements and commitments made from the Fund during the period less the amount of technical assistance expenses and sub-project dollar costs to be fully financed with loan funds. The GOP will reimburse to the sub-lending account 40 percent of total project costs incurred during the period. In essence what this means is that AID will reimburse BIP on

reimbursement vouchers, 60 percent of sub-loans made under the project and that an adjustment must be made on the reimbursement vouchers for any sub-loan projects paid by U.S. dollar loan disbursements. Our review of vouchers disclosed that no adjustments have been made on reimbursement vouchers for these disbursements. As a result, excessive loans disbursements have been made to BIP of \$168,723 (GOP 40 percent share of the U.S. dollar disbursement of \$421,809).

Recommendation No. 3

USAID should make the appropriate adjustment on reimbursement of loan funds to BIP to reflect U.S. dollar loan disbursements for sub-loan projects.

B. Affected Area

The financial status of loan funds allocated for the Affected Area at March 31, 1979 was:

	<u>Sub-loans</u>	<u>Technical Assistance</u>	<u>Total</u>
Funds Committed	\$1,600,000	\$100,000	\$1,700,000
Accrued Expenditures	<u>1,442,657</u>	<u>84,097</u>	<u>1,526,754</u>
Balance	<u>\$ 157,343</u>	<u>\$ 15,903</u>	<u>\$ 173,246</u>

Under the terms of the Loan Agreement, ORDENOR-CENTRO is to contribute to the project the equivalent of \$.5 million in support costs. At December 31, 1978, ORDENOR-CENTRO had contributed the equivalent of approximately \$3 million in support costs to the project.

During the early period of the loan, implementation of projects in the Affected Area was slow because of a shortage of personnel and administrative problems in the GOP implementing agency. However, these problems were resolved, and at March 31, 1979, 36 sub-loans totalling Soles 186.1 million had been approved for projects that are in various stages of implementation. When these sub-loan projects are completed, loan funds allocated for the Affected Zone will have been fully liquidated. Loan funds allocated for technical assistance are used to finance ORDENOR-CENTRO technicians that assist sub-borrowers to implement their projects and the cost of vehicles. Technical assistance loan funds will be fully utilized by the expected completion of all sub-loan projects in July 1979.

Sub-loans have been made to cooperative and individuals to finance agricultural type projects. Most projects are for the expansion of dairy farms but also include such other agricultural activities as sheep, pigs, poultry, bees and dairy products production.

No formal evaluation has been made by the USAID on the ORDENOR-CENTRO portion of the loan. However, status reports on sub-loan projects are made by ORDENOR-CENTRO and periodic visits and reviews of sub-loan projects are made by the USAID. Our review of these reports disclosed that projects have been implemented with a minimum of difficulties and have resulted in the expansion of enterprises receiving sub-loans and the creation of additional employment. Observations and discussions with sub-borrowers at four projects that we visited disclosed that they were happy to receive the loans, that the projects were doing well and that technical assistance received from ORDENOR-CENTRO technicians was beneficial. A formal evaluation and project completion report is scheduled by the USAID in July 1979, when the ORDENOR-CENTRO portion of the loan is expected to be complete.

REPORT RECIPIENTS

	<u>Copies</u>
Deputy Administrator, AID/W	1
Assistant Administrator, Bureau for Latin America and the Caribbean (LAC), AID/W	1
Mission Director, USAID/Peru	5
Country Officer, ARA/AND/B	1
Director, LAC/DP/PO, AID/W	3
Director, OPA, AID/W	1
DS/DIU, Room 105, SA-18, AID/W	4
AG, AID/W	1
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