

UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL

COOPERATIVE MARKETING PROJECT

PROJECT NO. 492-0300
(AID LOAN 492-T-051)

USAID/PHILIPPINES

Audit Report No. 2-492-82-07
March 25, 1982



Regional Inspector General for Audit
MANILA

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EXECUTIVE SUMMARY

In May 1978 AID loaned the Government of the Philippines \$6 million to support a nearly \$13 million (including AID's \$6 million) farmer cooperative organization throughout the Philippines. If successful, the project would provide marketing facilities, loans, technical assistance and access to supplies for about 90,000 small farmers belonging to 1500 village cooperative associations. And these services would be available at prices the farmers could readily afford.

The project has not been successful.

- . Only just over \$900,000 of AID's loan had been used -- almost \$5,000,000 should have been by June 1981. (pg. 3).
- . The project has been extended nine months to March 1983.
- . The entire implementation plan is cumbersome, ineffective, outdated and lacking in such basic elements as program benchmarks (pg. 3).
- . Support for the project by the Philippine Government has not effectively materialized (pgs. 3 and 4).

As a result as of June 1981, three years into the project for AID there has been little or no effective development of the cooperative structure, neither at the village level, the regional level, nor at the national level.

We recommended that USAID/Philippines not release any of the remaining uncommitted loan funds (about \$4,000,000) until the project is redesigned and an acceptable new implementing plan is developed (pg. 8).

We also noted that village level training programs were not being carried out (pgs. 8 and 9), and that various Government of the Philippines organizations were not adequately accounting for project resources which they provided (pg. 9). We made two recommendations to correct those shortcomings (pgs. 9 and 10).

BACKGROUND AND AUDIT SCOPE

Background

Preproject Development

There is a history of unsuccessful initiatives to establish cooperatives in the Philippines dating back to 1915. In 1973 the Government of the Philippines (GOP) started a new system designed to correct earlier weaknesses. For the first time farmers were to organize village level cooperatives - Samahang Nayan - (Village Co-ops) to channel to small farmers such basic support services as technical advice, cooperative education, agricultural credit, production inputs, and marketing. The Village Co-ops were to develop larger provincial-based Area Marketing Cooperatives (Area Co-ops) which were to provide supply, marketing and extension services to the Village Co-ops. The Area Co-ops were in turn to join a national organization called the Cooperative Marketing System of the Philippines (National Co-op). Exhibit A on page 11 presents the cooperative marketing structure.

Under the new system, credit to farmers was to be handled through Cooperative Rural Banks (Co-op Banks). The Co-op Banks were to be capitalized by the Village Co-ops and supervised by the Central Bank of the Philippines (Central Bank). The GOP also organized a Cooperative Development Loan Fund to provide loans to cooperatives, and a Management Training and Assistance Program to subsidize professional managers for the cooperatives.

By 1977, the GOP had organized over 19,700 Village Co-ops (representing 936,000 farm members) 38 Area Co-ops and 22 Co-op Banks.

The AID Project

To support the new program, AID lent the GOP \$6 million on May 3, 1978 (Loan 492-T-051) for the Cooperative Marketing Project. The objective of the project was to improve and facilitate the development of the cooperative marketing structure in the Philippines by providing two kinds of assistance to cooperatives -- loans and technical assistance. Loans were anticipated to 15 Area Co-ops and to the National Co-op to develop its marketing and supply operations. Technical assistance was to be provided to all levels within the cooperative marketing structure to strengthen managerial and technical capabilities. The primary intended beneficiaries of the project were about 90,000 small farmers who belonged to 1500 Village Co-ops that were to be assisted by the 15 Area Co-ops targeted for help under the project.

AID assistance to this program has been extended beyond the June 30, 1982 cut off date to March 31, 1983.

Project planning intended that four Philippines institutions serve as the project implementing agencies:

- The Central Bank to make loans to 15 targeted Area Co-ops and to the National Co-op for investments in physical facilities, equipment and working capital. The loans were to be extended through the Co-op Banks or other institutions. The finance system included four separate funds: (1) A Loan Fund for loans to Area Co-ops, (2) a Guarantee fund for guaranteeing loans, (3) an Area Co-op Trust Fund for preferred stock investments in Area Co-ops and (4) a Co-op Bank Trust Fund for equity investment in Co-op Banks.
- The Bureau of Cooperative Development (Co-op Bureau) to manage the project, finance management training and research and provide membership training for Village Co-ops.
- The Cooperative Foundation of the Philippines (Co-op Foundation) to provide technical assistance, training and management services and conduct research.
- The National Co-op to serve as a central marketing outlet and supply source for the Area Co-ops.

The project was estimated to cost \$12,780,000^{1/}, of which \$6,000,000 was to be contributed by AID, \$2,344,000 by the targeted Area Co-ops and Co-op Banks, and \$4,436,000 by the GOP. AID loan funds were to be mainly used for loans to cooperatives. Most of the GOP contribution was to be used to provide additional funds for the finance system as well as subsidies to cooperative organizations.

Scope

This was our first audit of the Cooperative Marketing Project financed under AID Loan 492-T-051. It covered the period from project inception, May 3, 1978 to June 30, 1981. Audit objectives were to evaluate (1) project accomplishments, (2) the operations and effectiveness of the implementing agencies, Area Co-ops, and Co-op Banks, and (3) how effectively AID resources were used.

Our audit was performed in accordance with standards for governmental audits, and included (1) a review of records, and discussions with project officials of the implementing agencies, National Economic and Development Authority, the USAID, Area Co-ops, Co-op Banks, and the Peace Corps, (2) a field trip to review the three project loans made to the Area Co-ops through the Co-op Banks, and (3) such other auditing procedures as we considered necessary.

A draft of this report was presented to USAID/Philippines for comments and this report incorporated the USAID comments as appropriate.

^{1/} Pesos have been converted to dollars in this report at the rate of ₱7.50 to \$1.00 unless otherwise indicated.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Project Accomplishments

Two major shortcomings in the Cooperative Marketing Project have caused the project to fall short of its anticipated goals:

- An unmanageable, outdated implementation plan.
- Inadequate host country support for the project.

For example, the GOP submitted the existing implementation plan to USAID in August 1978 pursuant to a condition precedent to the loan agreement. By November 1979 the USAID project manager had determined that the plan was inadequate, and outdated (among other deficiencies it lacked sufficient benchmarks for measuring project progress), and so advised the Interagency Coordinating Committee^{1/} repeatedly. In fact on March 10, 1981 the USAID in a letter to the GOP noted that they understood the GOP was revising the plan. Yet as of mid-February 1982 no revised implementation plan has been developed.

In the case of host country support the GOP has appeared to provide passive rather than active support to the project, and has not met its financial commitments to some of the implementing agencies (page 4).

In addition, the existence and operation of a poorly managed GOP Cooperative Development Loan Fund parallel with the Co-op Marketing Project has reduced demand for project loans and made it more difficult for Area Co-ops to qualify for project loans. (Page 6).

The overall effect of the above shortcomings has been an inability of the various implementing agencies to function effectively, resulting in little or no project progress. As of June 30, 1981 only three loans has been made to the Area Co-ops and none to the National Co-op and only \$904,000 of the AID loan had been expended compared to a projected amount of \$4,824,000 by June 30, 1981. The actual versus planned contributions to the project is shown in Exhibit B on page 12. These issues as well as others are discussed in the following pages.

The Cooperative Foundation of the Philippines, Inc. (Co-op Foundation)

The lack of feasibility studies to support loan applications from Area Co-ops has been a serious bottleneck in the lending operations of the project. As of June 30, 1981, only three loans have been granted to Area Co-ops versus 10 planned.

^{1/} The Interagency Coordinating Committee is responsible for insuring the implementation of the project according to plans and is composed of representatives from the implementing agencies.

The Co-op Foundation was supposed to assist Area Co-ops prepare feasibility studies for project loans as part of its overall responsibilities of providing management services. However, since it was organized in 1977, it had been unable to effectively provide technical assistance, training and management services to cooperatives or to conduct research in part because the GOP did not provide the required financial and management support. According to the loan agreement, the GOP was to provide the Co-op Foundation with a subsidy of \$200,000 over the life of the the project. The GOP never provided this subsidy and this has been a major reason why the Co-op Foundation could not perform effectively.

As a result the Co-op Foundation could not assist the Area Co-ops to prepare feasibility studies for project loans or provide other services to strengthen the cooperatives. As of June 30, 1981, the Co-op Foundation has only prepared one of the three feasibility studies for the three project loans that have been made. Hence, the Area Co-ops were not being developed or getting loans under the project as planned.

There have been some recent indications of improvements which, with adequate GOP support, could make the Co-op Foundation more effective. As of June 30, 1981, the Co-op Foundation had developed plans and secured funding to (1) provide 14 management training courses to cooperatives, (2) assist nine Area Co-ops prepare feasibility studies for project loans, (3) do research on project implementation, and (4) provide technical assistance to cooperatives.

The Cooperative Marketing System of the Philippines (National Co-op)

The GOP organized the National Co-op in 1975 as a private non-profit cooperative institution. Its main function was to serve the marketing and supply needs of its member Area Co-ops. However it has not been able to effectively serve the Area Co-ops because it has not become a viable, efficient organization. For example, some Area Co-ops targeted for assistance under the project in Mindanao have been informally coordinating their marketing and purchasing activities without assistance from the National Co-op. They plan to organize into a regional marketing and supply cooperative and possibly later affiliate with the National Co-op. This movement towards regionalization has taken place because the National Co-op has been unable to extend its operation in order to assist Area Co-ops outside of the Manila area.

Since the National Co-op started operations in 1975, it has consistently lost money and by the end of December 1980, it had an accumulated deficit of almost \$1,300,000 and a negative net worth of about \$155,000. In fact, the National Co-op has been unable to obtain a planned AID financed loan of \$675,000 from the Central Bank because of its poor financial condition and apparent inability to develop an effective business activity with support of its member cooperatives.

The operations of the National Co-op has been hurt mainly by losing real estate operations, loss of GOP operating subsidies, lack of Area Co-op membership support, and lack of GOP technical assistance. For example:

- . In calendar year 1980 the National Co-op lost nearly \$340,000 mostly in unprofitable real estate ventures.
- . Under the AID loan agreement the GOP agreed to subsidize the National Co-op. But for calendar years 1979 and 1980 the National Co-op received only \$63,000 from the GOP versus \$85,600 planned for those two years. No subsidy had been approved by the GOP for 1981. One immediate result of the unavailability of the GOP subsidies was that the National Co-op lost two of its managers. The broader result is that the National co-op has not been, and will probably not be, able to serve as the national marketing and supply organization for the Area Co-ops.
- . The by-laws of the National Co-op call for a nine-person Board of Directors of which four are to be designated by the GOP and five are to come from its member cooperatives. But the Area Co-ops only had three representatives on the Board of Directors, and the Board is chaired by a GOP representative.
- . Membership confidence and support of the National Co-op has been weak and relations between the Area Co-ops and National Co-op have not been satisfactory. Currently there are only 15 Area Co-ops (out of 42) that are members of the National Co-op and only five of these are in the target group for assistance under the project. The Area Co-ops claim that the National Co-op has not adequately served their needs. At the same time, the National Co-op believes that many of the Area Co-ops have not honored their commitments to deliver products to the National Co-op in the agreed quantities and qualities or pay their debts to the National Co-op when due. There is probably validity to both of these views.
- . In October 1979 the GOP contracted with a consulting firm - Agricultural Cooperative Development International. The contract included technical assistance for the National Co-op to develop inter alia a central marketing and supply complex to be financed with a project loan. However, little progress has resulted from the contractors efforts to obtain improvements in the marketing and supply operations. The National Co-op did not accept consultant recommendations which might have improved its operations, increased its business and perhaps allowed it to qualify for a loan. Instead the National Co-op has remained intransigent and unable to qualify for the loan.

Notwithstanding the fact that it may be premature to provide assistance to the National Co-op to develop a central marketing and supply complex, the National Co-op clearly needs continuing assistance if it is to improve its marketing and supply operations and its services to Area Co-ops.

The Cooperative Development Loan Fund (Co-op Loan Fund)

A GOP Co-op Loan Fund was created in April 1973 to provide loans to support the development of the cooperative system. The fund has been mainly financed by GOP budgetary appropriations and loan repayments had to be returned to the GOP Treasury. However, in May 1981, the operation of the fund was changed to a revolving fund so that reflows could be relent. The Co-op Loan Fund is managed by a Committee under the Ministry of Agriculture.

Since the inception of the Co-op Loan Fund in 1973 through December 1980, it has disbursed loans to 52 cooperatives for a total of about \$11,300,000 of which only \$140,685 has been collected. Co-op Loan Fund officials asserted that the poor repayment record is due to insufficient funds to maintain an adequate technical staff and the requirement that loan repayments reverted to the GOP Treasury. This latter point reduced incentives to collect loans since reflows couldn't be relent; it also encouraged the granting of loans for longer periods than necessary in order that capital could be retained in the cooperative system.

In May 1980, the President of the Philippines announced that the GOP was going to appropriate an additional \$6,600,000 for the cooperative program. While these funds were never given to the Co-op Loan Fund, we believe there was sufficient publicity generated to cause some Area Co-ops to defer applying for loans under the Co-op Marketing Project in hopes of getting the softer loans from the Co-op Loan Fund.

To try to improve coordination between the Co-op Loan Fund and the Cooperative Marketing Project, the Ministry of Agriculture in October 1980 evaluated the financial condition of all 42 Area Co-ops in the country to determine whether they should be financed by the Co-op Marketing Project or the Co-op Loan Fund. Eighteen Area Co-ops were classified for financing under the Co-op Marketing Project (only four of the 18 was included in the original 15 targeted for project financing in the project paper). Of these 18 Area Co-ops, five had been earning money for more than one year, nine recently started to make money and four were newly organized. Eleven Area Co-ops, which were losing money, were classified for financing by the Co-op Loan Fund and the remaining thirteen Area Co-ops, which had negative net worths were classified for rehabilitation or liquidation.

Since most of the Area Co-ops had outstanding loans with the Co-op Loan Fund, the Co-op Marketing Project required the Area Co-ops to obtain deferrals of the payments due the Co-op Loan Fund. This created friction between the managers of the Co-op Marketing Project

1/ 1980 Annual Report of the Co-op Loan Fund

and the Co-op Loan Fund. The Co-op Loan Fund would prefer not to reschedule its loans since reflows are now an important source of capital for its lending operations.

In sum, we believe the Co-op Loan Fund has been poorly managed and has had detrimental effects not only on the implementation of the Co-op Marketing Project but also on the development of the cooperative system in the Philippines.

Cooperative Rural Banks

Area Co-op loans under the project were to be made through Co-op Banks or other banks. The Co-op Banks also make production loans to farmers. While these production loans were not financed under the Co-op Marketing Project, they were important to the project because they were frequently used to finance Area Co-op sales of crop-producing supplies to farmers. The Central Bank regulates and supervises the Co-op Banks, and other banks.

Loan delinquencies for production loans made by the Co-op Banks were increasing because of weaknesses in bank management. A study done of the Co-op Marketing Project in 1979 by the Agricultural Credit and Cooperative Institute disclosed an increasing proportion of past due loans between the Co-op Banks and farmers. The survey showed that the value of loans past due for six Co-op Banks increased from about 18 percent as of December 31, 1978 to over 28 percent as of June 30, 1979. During our field trip to a Co-op Bank, in North Cotabato we found that its production loan delinquencies had been increasing and as of June 27, 1981, over 23 percent of the value of loans outstanding were delinquent. The Central Bank advised us that the delinquency trend was increasing nationally and that 27 percent of loans made by all Co-op Banks and other rural banks were delinquent.

According to Central Bank rules, Co-op Banks can not rediscount their production loans with the Central Bank, once past due loans exceed 25 percent. Unless the delinquency trends are reversed, this will weaken or cause the failure of the Co-op Banks and also the Area Co-ops who depend on Co-op Bank credit to finance sales of crop-producing supplies to farmers.

To correct the adverse delinquency trend, the study recommended that the Co-op Banks engage the support of the Village Co-ops in effecting a systematic way of collecting loans from Village Co-op farmer members, develop a system of screening out potential delinquent borrowers and improve their loan collection methods.

Officials of the North Cotabato Co-op Bank said they encourage farmers to diversify production so crop failures caused by insects and weather will not impact as unfavorably on production. The manager of the North Cotabato Area Co-op said the farmers need to receive more extension services from the Ministry of Agriculture. The Co-op Bank in North Cotabato only has three field personnel to supervise its loans.

During our visit to Agusan del Sur Area Co-op, we found that a private bank servicing the Area Co-op had collected nearly 100 percent of its most recent production loans because it requires each farmer belonging to a Village Co-op to sell his first 2,000 kilos of unprocessed rice to the Area Co-op, and production loans are then paid off before the net proceeds are given to the farmer.

Conclusion

In view of the poor performance of the agencies responsible for implementing this project and the fact that the present implementation plan is outdated and ineffective the following recommendation is presented for USAID/Philippines' action:

Recommendation No. 1

USAID/Philippines withhold release of additional funds under Loan 492-T-051 until the Loan Agreement Annex 1 and Attachments 1 and 2 (Project Description and Budgets) are properly amended and a revised implementation and supporting financial plan is submitted to the USAID which explains the deficiencies in the past operations of the principal agencies and sets forth corrections to be made in order to achieve the objectives of the project. The plan should, as a minimum:

- a) clarify the roles of the Bureau of Cooperative Development, Cooperative Foundation of the Philippines, Cooperative Marketing System of the Philippines, Central Bank and the National Economic and Development Authority in the implementation of the project;
- b) account for the past use of counterpart resources (both in kind and budgetary);
- c) revise the allocation of remaining resources in consonance with the modified responsibilities of the participating agencies and terminal date of the project;
- d) set forth the functional and operational relationship between the Cooperative Development Loan Fund and the Cooperative Finance System under the Cooperative Marketing Project.

Training to Village Co-ops

The Bureau of Cooperative Development (Co-op Bureau) has not provided the required training for membership education and organizational

development for some 1500 Village Co-ops belonging to Area Co-ops targeted for assistance under the project. The required training was not provided because of the lack of funds and a change in the Area Co-ops targeted for assistance.

According to the Loan Agreement, the Co-op Bureau agreed to spend \$249,000 for Village Co-op training during the first two years of the project. However, they have only spent \$52,000 for such training in 1978 and 1979 to Village Co-ops belonging to the 15 Area Co-ops originally targeted for assistance under the project. Furthermore, because of a change in the Area Co-op target group in October 1980 (page 6), only five Area Co-ops of the new target group of 18 have been covered by the training program. Many of the Area Co-ops originally targeted for assistance were losing money and encountering other management conditions to prevent them from qualifying for project loans. The target group was changed to the better managed Area Co-ops to allow project resources to be used more effectively.

Since the success of the cooperative system is largely based on viable and responsible Village Co-ops, the Co-op Bureau should continue with its Village Co-op training program which should be expanded to include those Village Co-ops not covered by the training given in 1978 and 1979.

Recommendation No. 2

USAID/Philippines obtain evidence that the Co-op Bureau has implemented an acceptable plan for the training of Village Co-op members belonging to the current targeted Area Co-ops.

Accounting for Project Resources

The GOP has not maintained records on the contributions made to the project by the various organizations involved. This is required by the loan agreement which provides that the GOP will maintain, or will cause to be maintained, records on overall project progress. Without such records, USAID and GOP managers can not determine whether the implementing organizations have made their required contributions as specified by Annex I of the Loan Agreement.

The prompt identification and correction of such problems are crucial to project success. Had the lack of GOP financial support to the Co-op Foundation and the National Co-op been promptly identified and corrected by the project managers, project implementation could have been more advanced than it presently is.

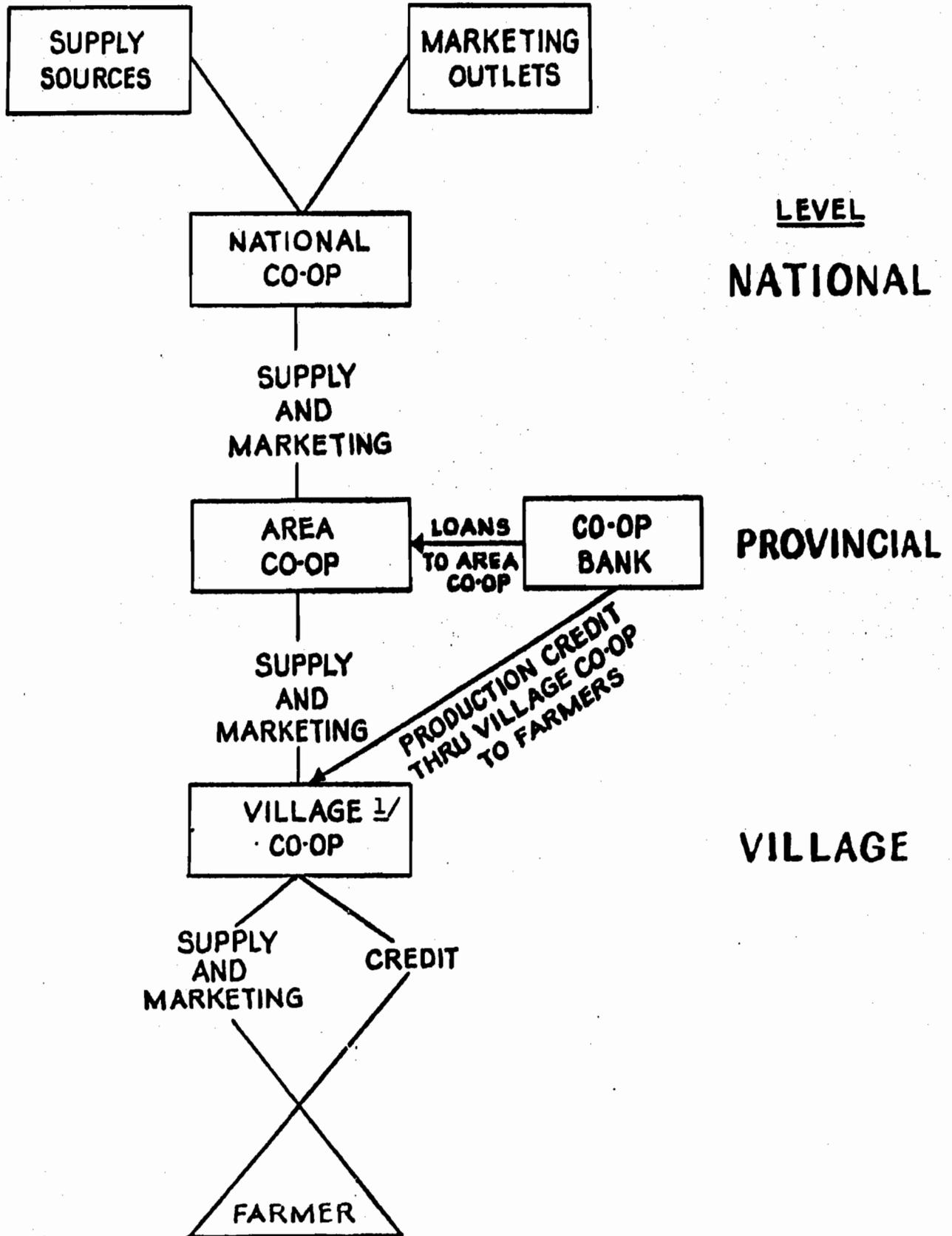
To complement those actions called for in Recommendation 1, page 8, we also think USAID/Philippines should implement the following action:

Recommendation No. 3

USAID/Philippines require the GOP to maintain, or cause to be maintained, records on project inputs so that actual performance can be compared to plans.

COOPERATIVE MARKETING PROJECT

COOPERATIVE MARKETING SYSTEM STRUCTURE



Cooperative Marketing Project
Project Contributions
Planned Versus Actual as of June 30, 1981

	<u>Contributions (\$000)</u>			<u>Difference Over (Under)</u>
	<u>Total Planned</u>	<u>First Two Years</u>		
		<u>Planned</u>	<u>Actual</u>	
AID - Loan 492-T-051	<u>6,000</u>	<u>4,824</u>	<u>904</u>	<u>(3,920)</u>
Project Beneficiaries ^{1/}	<u>2,344</u>	<u>1,803</u>	<u>NA</u> ^{2/}	<u>-</u>
Government of the Philippines - In Kind	<u>417</u>	<u>271</u>	<u>NA</u>	<u>-</u>
Government of the Philippines - Monetary				
Co-op Bureau	2,193	1,476	1,162	(314)
Central Bank	954	949	1,840	891
Co-op Foundation	200	133	22	(111)
National Co-op National Economic Dev. Authority	480	320	NA	-
	<u>192</u>	<u>134</u>	<u>89</u>	<u>(45)</u>
	<u>4,019</u>	<u>3,012</u>	<u>NA</u>	<u>-</u>
Total Project	<u>12,780</u>	<u>9,910</u>	<u>NA</u>	<u>-</u>

1/ Member investments (savings) in Area Co-ops and Co-op Banks.

2/ Data not available.

REPORT RECIPIENT

USAID/Philippines

Director 5

AID/W

Deputy Administrator 1

Bureau for Asia:

Assistant Administrator 1

Deputy Assistant Administrator (Audit
Liaison Officer) 1

Office of the Philippines, Thailand
& Burma Affairs (ASIA/PTB) 1

Bureau for Science & Technology:

Office of Development Information &
Utilization (S&T/Mgt) 4

Directorate for Program & Management Services:

Office of Contract Management (M/SER/CM) 3

Office of the Inspector General:

Inspector General (IG) 1

Executive Management Staff (IG/EMS) 12

Policy, Plans & Program (IG/PPP) 1

Office of Legislative Affairs (LEG) 1

Office of Financial Management (OFM) 1

Office of the General Counsel (GC) 1

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RIG/A/Abidjan (West Africa) 1

RIG/A/Cairo (Egypt) 1

RIG/A/Karachi (Near East) 1

RIG/A/Latin America 1

RIG/II/Manila 1