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UNITED STATES  
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE  
INSPECTOR  
GENERAL

AUDIT REPORT  
ON  
FERTILIZER PROMOTION PROJECT  
NO. 386-0471  
(LOAN NO. 386-T-226 AND 226A)  
USAID/INDIA

AUDIT REPORT NO. 5-386-83-5  
MARCH 22, 1983



Regional Inspector General for Audit  
KARACHI

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EXECUTIVE SUMMARY

Introduction

The Fertilizer Promotion Project is designed to assist the Government of India (GOI) sustain the momentum of increased fertilizer consumption established between 1976 and 1979. This purpose is to be achieved through: (1) a continuation of the GOI fertilizer import program to ensure adequate supplies at the local level; and (2) a supplementation of ongoing activities to broaden the base of fertilizer consumption, especially in remote areas.

The AID mission originally agreed to provide loans totaling \$150 million for the project, but only \$101 million was actually provided. AID/W subsequently decided against funding the remaining \$49 million because the project does not involve policy or institutional reforms, or technology transfer.

As of October 31, 1982 loan disbursements totaled \$66.3 million for the 221,836 metric tons of fertilizer received in India between January and April 1981. Purchases against the remaining \$35 million have not yet been approved by the mission.

Purpose and Scope

The primary purposes of our audit were to determine if the project is accomplishing its objectives, and if the AID funds were spent in compliance with the terms of the loan agreement and other documents.

Our review included an examination of project documents and records available at the mission, the GOI and selected distributing agencies; discussions with appropriate agency and government personnel; and visits to selected warehouses where AID-financed fertilizer was stored.

### Findings, Conclusions and Recommendations

- For various reasons, fertilizer consumption did not increase at the rate projected during two of the first three project years. These reasons include steep price increases and poor weather conditions. Consumption in the current year is also expected to be lower than projected.

As a result of the lower than projected consumption, there is presently reported to be an over-supply of fertilizers in India. We verified that there is a considerable quantity of AID-financed fertilizer still in storage almost two years after being received. Consequently, we have recommended that the mission should (a) not approve disbursement of the remaining \$35 million left under the loan until these issues have been satisfactorily resolved, and (b) the Government of India revises its distribution system to prevent the build-up of excess fertilizer inventory. (See pp. 5-6.)

- While the GOI has taken actions to broaden the base of fertilizer consumption, the impact of these action is not yet known because of a lack of information. In addition, the GOI did not furnish us information on the resources it provided for the project. (See pp. 6-7.)
- The mission did not establish the required reporting and evaluation program for the project. We believe this factor, together with a lack of monitoring in the project's early stages, may have been responsible for the Ministry of Agriculture's less than responsive attitude toward later mission monitoring requests and our audit. We have recommended corrective action be taken to prevent similar problems in the future. (See p. 8.)

A draft of this report was sent to the mission for review and its comments were considered in preparing the final report.

## BACKGROUND

The Government of India (GOI) has set a target of four percent annual increase in agricultural production for the five years between 1978 and 1983. Attainment of this target is dependent on three complementary activities - (1) increase in irrigated acreage, (2) creation of additional electrical power for operation of minor irrigation schemes, and (3) progressive growth in fertilizer consumption. AID, through its India mission, is providing bilateral assistance to the GOI in all these areas. The main thrust of the AID assistance has been to help increase agricultural production, with particular emphasis on raising the incomes of small farmers.

The purpose of AID participation in the fertilizer promotion project is to assist in sustaining the momentum of increased fertilizer consumption established between 1975 and 1979. One of the factors responsible for the increase was the effectiveness of the government import program which ensured ready supply of fertilizer. This project supports a continuation of that import policy. Specifically it emphasizes (a) importation of chemical fertilizers, and (b) supplementation of ongoing GOI activities to broaden the base for fertilizer consumption, especially in remote areas. The major portion of the AID-financed fertilizer is directed toward small farmers in backward and remote farming areas.

The project basically involves the transfer of money to the GOI for importing fertilizer. Initially AID was to provide \$150 million in incremental loan funding to help the government cover an estimated import bill of \$1.5 billion between 1979 and 1981. However, the loan agreement dated September 28, 1979 and its amendments provided only \$101 million. In July 1982 AID/W made the decision not to fund the remaining \$49 million because the project does not involve policy or institutional reforms, or technology transfer.

As of October 31, 1982 disbursements of \$66.3 million have been made for 221,836 metric tons of fertilizer received between January and April 1981. Terms and conditions of the second invitation for bid for purchase of the remaining \$35 million of fertilizer have been completed, but the purchase has not yet been approved by the AID mission in Delhi.

The loan is repayable in U.S. dollars within 40 years, including a 10 year grace period, from the date of the first disbursement which occurred in January 1981. The interest rate is 2 percent per annum during the grace period, and 3 percent thereafter on the outstanding balance including

any due and unpaid interest. The project completion date is June 30, 1983.

The GOI Ministry of Agriculture is the implementing agency. Procurement of the fertilizer is to be made by the Mineral and Metals Trading Corporation, a GOI corporation. Port handling and distribution are done by six public and joint sector agencies appointed by the government.

#### Purpose and Scope

This audit was made to determine if the project is accomplishing its objective and if it is being implemented in compliance with terms of the loan agreement and AID regulations. We made tests of records and documents considered necessary, held discussions with mission or GOI officials, and visited three of the five agencies handling AID-financed fertilizer. We also visited selected warehouses of clearing agencies in the states of Karnataka and Uttar Pradesh to further test check the distribution and sale of fertilizer.

## AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

### A. PROJECT IMPLEMENTATION

#### 1. Fertilizer Availability and Use

Although adequate supplies of fertilizer were available, consumption has not increased at the projected rate. Consequently, at present, there is reported to be an over supply of fertilizer in India.

According to published Ministry of Agriculture statistics, total annual domestic production, imports and consumption of fertilizers during the preceding four years were as follows:

<u>Year</u>	<u>Production</u>	<u>Imports</u>	<u>Consumption</u>
1978-79	2,951	1,994	5,117
1979-80	2,987	2,006	5,255
1980-81	3,005	2,759	5,516
1981-82	4,090	2,042	6,064

As is evident from these figures, the GOI maintained the momentum of fertilizer imports thereby meeting one of the objectives of the project. Fertilizer imports increased by about 37.5 percent in 1980-81, but fell the following year because of a large increase in domestic production. The 36 percent increase in domestic production in the 1981-82 year was attributed to better utilization of facilities, and improvements in raw materials and electrical power availability.

Stocks in the pipeline and inventory, heavy imports and higher domestic production ensured an adequate availability of fertilizer to meet demand. As a result, absolute consumption increased. The consumption growth rate, however, was less than the annual average of 20 percent increase achieved between 1976-79. It was also much less than the project target rate of 10 percent per year set for the 1979-1981 years. Consumption increased only 2.7 percent in 1979-80 and 4.9 percent in 1980-81. The GOI subsequently established a consumption target growth rate of 18% for 1981-82 year in an effort to offset decreased rates of the previous two years. The rate, however, increased by only 9.9 percent in that year.

Poor rains and other factors were reportedly responsible for decrease in the consumption rate. The other factors were two successive retail

price increases totaling about 62 percent in 1980 and 1981, lack of adequate credit facilities, failure of the farm extension agencies to reach the small and marginal farmers, and transportation and warehouse problems. The Indian fertilizer industry believes that more remunerative prices to the farmers for their produce, reduction in fertilizer prices, and improved agricultural extension efforts to reach the small and marginal farmers can boost fertilizer consumption.

Government officials have taken several steps to counteract the adverse effects of increased prices. These include raising the purchase price of crops, paying transportation charges for delivery of fertilizer to block headquarters (a GOI administrative unit) instead of only to rail heads, increasing the mark-up on distribution costs by about 22 percent, and launching a fertilizer promotion campaign to cover 103 districts as against the earlier 67.

No specific information is yet available to show what effects these measures have had on fertilizer consumption in the country. Total consumption in the three years from 1979 to 1982 totaled about 17 million tons. According to recent newspaper reports, the consumption growth rate in 1982-83 will at most be 4 percent as opposed to a government target rate of 18 percent. Based upon a 4 percent increase, cumulative consumption during the 1979-1983 period will total about 23 million tons against a projected target of 25 million tons.

According to newspaper articles, the lower consumption rate has caused a build-up of fertilizer stocks. Reportedly, stocks were 2 million tons in excess of requirements at the start of the current summer sowing season. Another reason cited by newspapers and the Fertilizer Association of India for the stock increase, was the fact that established targets were unrealistic. Imports were based upon inflated requirements projected by the various state governments.

The lower rate of consumption has also effected the utilization of AID-financed fertilizer. Both our field visits and mission monitoring reviews have disclosed that a considerable quantity of AID-financed diammonium phosphate (DAP) is still in warehouses 19 to 22 months after being received. The following table shows the extent of unused DAP at the warehouses visited:

<u>Visited By</u>	<u>Number of Warehouses Visited</u>	<u>Total (in MT)</u>		
		<u>Receipts</u>	<u>Balance in Stock</u>	<u>Percentage</u>
Auditors	10	16,820	12,994	77%
USAID	12	35,946	15,962	45%
		<u>52,766</u>	<u>28,956</u>	<u>55%</u>

Visits were made to selected warehouses of 3 agencies which had been consigned 190,403 (86 percent) of the total 221,836 metric tons of fertilizer imported under the AID loan. Non-utilization was observed at the warehouses of all 3 agencies visited. The highest percentage of non-utilization was found at the Food Corporation of India (FCI), which had received 66,782 metric tons of AID-financed DAP. Mission officials and the auditors examined receipts for 23,329 metric tons (35 percent) of the total received and found about 90 percent still in storage. In the case of another agency, the Mangalore Chemicals and Fertilizers Limited (MCFL), about 40 percent of the AID-financed DAP was still in storage.

Mission officials, however, have received information from the Ministry of Agriculture to the effect that the current over supply of fertilizer does not apply to DAP. This is what the government intends to import with the balance of the AID loan. According to MOA figures, one million tons of DAP will be needed during calendar year 1983. Of this amount, 700,000 tons are presently in stock; 440,000 tons are held by the Food Corporation of India and 260,000 tons are held by others. Of the stock held by FCI, however, only about 100,000 tons are assumed to still be good; 250,000 tons of the total held by others are assumed to still be good. This brings the total of stocks on hand deemed useable to 350,000 tons. Domestic production for calendar year 1983 is estimated at 270,000 tons. The 350,000 tons of good stock on hand plus the 270,000 tons to be produced, brings the total to 620,000 tons. This means that 380,000 tons of DAP will have to be imported to meet projected 1983 demand.

At the same time, however, the Ministry of Agriculture has also indicated to the mission that the 440,000 tons of DAP in stock at FCI may in fact still be good. No one is certain of the quality because no test for deterioration have been made. If the 440,000 tons of DAP are good, then there should be no need for further imports and no need for the AID loan.

#### Conclusion and Recommendation

The picture of fertilizer supply or over-supply in India is very cloudy. Reports of a fertilizer glut persist. In a February 1983 newspaper report, the Fertilizer Association of India told the GOI there is no need

to import fertilizer at this time. No one is certain how much of the 440,000 tons of DAP that the Food Corporation has in stock is still useable. Given this situation, we believe the mission should be very cautious about approving disbursement of the remaining \$35 million for additional purchases. Firm figures concerning overall supplies on hand, production, and estimated consumption are essential. Only when these figures are available will the mission be in a position to assess whether additional AID-financed imports are needed.

Moreover, there is the matter of 440,000 tons of DAP fertilizer at the FCI which may have deteriorated because it sat in the warehouse for too many months. This indicates there is something wrong with the distribution system. In our view, the Ministry must revise its distribution system to prevent this from happening again before AID agrees to finance more of the same fertilizer. If a substantial portion of the 440,000 tons of DAP on hand at FCI is in fact not useable, this would represent a loss to the Government of India in the neighborhood of \$100 million at current replacement prices.

#### Recommendation No. 1

The Director, USAID/India, should not approve disbursement of the remaining \$35 million of loan funds until the GOI (a) produces firm figures concerning supplies on hand, consumption and production which will enable the mission to assess whether additional AID-financed imports are needed, and (b) revises its distribution system to prevent the build up of excess inventory at agencies acting on its behalf.

#### 2. Progress On Other Activities

Actions have been taken by the GOI which are designed to broaden the base for fertilizer consumption. The impact of these actions is not yet known, however, because of a lack of information.

The government is attempting to broaden the base of fertilizer consumption by; (a) increasing the number of districts, especially in dryland areas, in which intensive fertilizer promotion campaigns are to be waged; (b) adding to the villages currently adopted by the fertilizer industry; (c) providing promotional subsidies to small farmers through special credit programs; and (d) developing a system of incentives and improved distribution to increase fertilizer supplies in remote areas.

The government has extended the campaign program to 103 districts from the original 67. In April 1981 it also started a program to subsidize transport of fertilizer as far as block headquarters. In the past transportation subsidy was available for deliveries only to rail heads. Since 58 percent of the blocks did not have rail connections, the distribution agencies had to pay transportation costs from the nearest rail head to the block.

Government officials informed us that steps have been taken to improve the retail distribution network within the blocks to ensure a more equitable distribution of fertilizer. The number of sale points has been increased from 101,839 in 1978 to 111,927 in 1981. Another 11,000 have been established in 1982-83 out of 15,000 planned. The distribution margin on fertilizer was also increased by about 22 percent in August 1981.

The government reportedly subsidizes phosphatic and potassic fertilizers purchased by small and marginal farmers at the rates of 25 percent and 33-1/3 percent, respectively. Yearly data on the participation of small and marginal farmers was not available at the time of our review. GOI officials did tell us, however, that such farmers represent about 65 percent of all the farmers in the country, and that they use about 31 percent of total fertilizer consumed in the country. According to other available information, however, there is a general lack of adequate credit facilities available to these farmers. This, coupled with past price increases, were cited as reasons for the slow consumption growth rate.

In summary, the GOI has initiated actions to broaden the base for fertilizer consumption. However, there is no empirical data yet available to show what impact these measures are actually doing improve fertilizer availability and consumption in remote and backward areas.

## B. PROJECT MONITORING AND EVALUATION

Mission monitoring, of the project which was not altogether adequate in the beginning, did improve substantially during the later stages. The mission has not, however, established the required reporting and evaluation program for the project. This we believe may have contributed to the difficulties encountered by both USAID officials and us in the performance of our audit.

The project paper stated that the mission will monitor progress of the project through regularly scheduled meetings with the Ministry of Agriculture and other agencies responsible for project implementation. The paper further states that an evaluation program will be established by the government, and essential elements thereof will include a routine annual evaluation of progress toward attainment of project objectives. The kinds of data required for the evaluation were to be agreed upon by the mission and the government and the evaluation work was to be guided by a steering committee in the Ministry in which the USAID was to be represented. The project evaluation clause was included in the loan agreement and implementation letter No. 2.

The mission did not, however, hold regular discussions to monitor project progress or take any of the prescribed actions to formalize the evaluation procedures or program. Consequently, the required annual evaluations to determine project progress were not performed. Neither did the mission issue guidelines for monitoring, nor did it receive required periodic shipping and progress reports.

Finally, USAID did not begin monitoring utilization of AID-financed fertilizer until June 1982, almost 15 months after it was received in India. Thereafter, the mission made several comprehensive utilization reviews. To some extent, the delayed monitoring visits were the result of the Ministry taking an unreasonably amount of time to grant the necessary clearance. For example, Ministry concurrence requested by the mission in November 1981 was not received until several month later. Similarly, clearance for the audit was delayed for two months, and even then, some of the program information we requested was not furnished.

This attitude resulted in delays and difficulties in the performance of our audit. Despite assurances, it may be that the matter has still not been satisfactorily resolved. For example, Ministry concurrence was not received until the end of January for a joint field trip that mission officials and the auditors wanted to make on January 10 to determine the current status of AID-financed fertilizer.

Recommendation No. 2

The Director, USAID/India, should issue an implementation letter to formalize the reporting and evaluation procedures specified in the project paper if it is decided to approve disbursement of the remaining loan amount of \$35 million.

Recommendation No. 3

The Director, USAID/India, should appropriately amend the existing implementation letter format to highlight AID monitoring and audit rights, and require the implementing ministries be informed of these rights.

### C. SHORTAGE/DAMAGE CLAIMS

The agencies responsible for the handling and distributing loan-financed shipments have filed claims for shortages and damages for Government of India, and also have been taking necessary follow-up action on the claims.

In the case of commodity shipments examined by us, the concerned agencies had filed five claims for losses. Three of these five claims were later dropped because for various reasons, they were considered legally untenable by the government. The other two claims for Rs. 1,282,565 (\$160,686) were pending at the time of our audit. The details thereof are furnished below:

<u>Vessel</u>	<u>Agency</u>	<u>Shortage Qty. (MT)</u>	<u>Claim Amount</u>
Columbia	SPIC	219.7 DAP	Rs. 647,610
Grace Five	MCFL	238.9 Urea	<u>634,955</u>
			<u>Rs. 1,282,565</u>

Moreover, there may be additional claims filed by agencies we did not visit. In November 1981 the mission requested the Ministry of Agriculture to furnish details on all claims, but so far, this has not been done.

Section C-7(b) of Annex 2 of the loan agreement requires that any indemnification received by the government for claims should be used to replacement subject to the provisions of the agreement. Therefore, we believe the mission should maintain details and status on all claims to ensure that the government complies with this provision of the loan agreement.

#### Recommendation No. 4

The Director, USAID/India, should: (a) obtain the details and current status of all claims filed for loan financed shipments, and (b) request the GOI to refund any indemnification received that are not used for replacement required by Section C-7(b) of Annex 2 of the loan agreement.

LIST OF RECOMMENDATIONS

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The Director, USAID/India, should not approve disbursement of the remaining \$35 million of loan funds until the GOI (a) produces firm figures concerning supplies on hand, consumption and production which will enable the mission to assess whether additional AID-financed imports are needed, and (b) revises its distribution system to prevent the build up of excess inventory at agencies acting on its behalf.

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Recommendation No. 2

The Director, USAID/India, should issue an implementation letter to formalize the reporting and evaluation procedures specified in the project paper if it is decided to approve disbursement of the remaining loan amount of \$35 million.

9

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The Director, USAID/India, should appropriately amend the existing implementation letter format to highlight AID monitoring and audit rights, and require the implementing ministries be informed of these rights.

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The Director, USAID/India, should: (a) obtain the details and current status of all claims filed for loan financed shipments, and (b) request the GOI to refund any indemnification received that are not used for replacement required by Section C-7(b) of Annex 2 of the loan agreement.

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LIST OF REPORT RECIPIENTS

<u>USAID/India</u>	
Director	5
<u>AID/W</u>	
Bureau For Asia	
Assistant Administrator (AA/ASIA)	2
Office of Bangladesh and India Affairs (ASIA/BI)	1
Audit Liaison Officer	1
Bureau For Science and Technology	
Office of Development Information and Utilization (S&T/DIU)	4
Office of Agriculture (S&T/AGR)	1
Bureau For Program and Policy Coordination	
Office of Evaluation (PPC/E)	1
Bureau For Management	
Assistant to the Administrator For Management (AA/M)	1
Office of Financial Management (M/FM/ASD)	2
Directorate For Program and Management Services	
Office of Management Operations (M/SER/MO)	1
Office of Contract Management (M/SER/CM)	1
Bureau For External Relations	
Office of Legislative Affairs (EXRL/LEG)	1
Office of General Counsel (GC)	1
Office of Public Affairs	1
Office of Inspector General:	
Inspector General (IG)	1
Communications and Records Office (IG/EMS/C&R)	12
Policy, Plans and Programs (IG/PPP)	1
Regional Inspector General For Audit:	
RIG/A/W	1
RIG/A/Nairobi	1
RIG/A/Manila	1
RIG/A/Cairo	1
RIG/A/Latin America	1
RIG/A/Abidjan	1
<u>Other</u>	
RIG/II/Karachi	1
New Delhi Residency, RIG/A/K (AAP)	3