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AUDIT OF
RURAL HOUSING IMPROVEMENT PROJECT
USAID/HONDURAS (522-0171)

AUDIT REPORT NO. 1-522-86-04
DECEMBER 4, 1985

AGENCY FOR INTERNATIONAL DEVELOPMENT

OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

December 4, 1985

MEMORANDUM:

TO : Mr. Anthony J. Cauterucci, Director, USAID/Honduras

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

Coinage N. Gothard

Subject : Audit Report No. 1-522-86-04, Audit of Rural Housing Improvement Project, USAID/Honduras (522-0171)

Attached for your information and use are five copies of the subject audit report.

The project had basically achieved its planned level of results. For example, 7,978 sub-loans out of 8,000 projected sub-loans had been made as of June 30, 1985. Also, prior to this project, rural families had not had any dealings with local banks. As a result of collection practices established by one participating PVO, Hermandad de Honduras, its beneficiaries had to deal directly with local banks. This new-found relationship stimulated an interest for savings accounts and an understanding of the importance of timely loan repayment. Prior to this project, the PVOs main source of funds were donations from abroad for which they did not always have to maintain an accounting system for the funds donated. Because the funds received from the National Housing Institute (Institute) under the AID Project Agreement were in the form of loans, the PVOs had to institute accounting systems to account for the use of these funds. The Institute provided training in bookkeeping, thereby also benefiting other parallel projects being carried-on by the PVOs. Moreover, the beneficiaries were making badly needed improvements to their houses such as putting concrete floors and permanent roofs where none existed previously. The improvements have made the homes more livable for the beneficiaries, both physically and psychologically.

One area where project implementation has lagged slightly was in the rate of disbursements. According to project plans, the $3.5 million project was to be completed by June 1, 1986. As of June 30, 1985, $2,013,822 had been expended, or about $445,677 short of projected expenditures as of the same date. The USAID was aware of this problem and has taken steps to accelerate the expenditure of money by expanding the use of project funds for new home construction and increasing the number of PVOs participating in the project.

In our opinion, an effective system for measuring project results had been established; however, the system could be improved by including procedures for reporting subloans in arrears, so the USAID and the Institute can effectively monitor sub-loan delinquencies, and thereby, the PVOs' management of their loan portfolios.

PVO compliance with provisions of the AID Project Agreement was not satisfatory. We found many instances where the PVOs made ineligible loans or had not used project funds for intended purposes. PVO officials were either new at their job or lacked the proper training tc administer the program. Although many sub-loans did not comply with program eligibility requirements, most were made within the spirit of the program to help the rural poor and improve housing. Also, PVO officials indicated their willingness to correct these past practices and to administer the funds as required in the Institute/PVO loan agreements.

The Institute had established a system to monitor compliance with project requirements, but the scope of the reviews done by the Institute's auditors was too limited to effectively identify all areas of non-compliance.

This report includes eight recommendations to improve the Institute and PVO administration of the project. USAID/Honduras started corrective actions on all audit recommendations while the audit was in process. As a result of these actions, two recommendations will be closed upon publication of this report.

Please advise this office within 30 days of the actions planned or taken to implement the remaining six open recommendations contained in this report.

EXECUTIVE SUMMARY

The Office of the Regional Inspector General for Audit/Tegucigalpa performed an audit of USAID/Honduras' Rural Housing Improvement Project No. 522-0171. We reviewed compliance with the project requirements for the home improvement credit component of the project and evaluated overall project results. The specific objectives of this audit were to determine whether:

- the project had achieved its planned level of results,
- USAID/Honduras and the National Housing Institute (Institute) had established an effective system for measuring project results,
- the Private Voluntary Organizations (PVOs) had used project funds for intended purposes,
- the National Housing Institute had established an effective system to monitor PVO compliance with project requirements.

The project had been generally successful in achieving its targets. With one year of project life remaining, participating PVOs had made 7,978 sub-loans of 8,000 sub-loans planned for the project as of June 30, 1985. In addition, the project had increased the institutional capacity of the Institute and the PVOs to manage a program of home improvement and construction loans for the rural poor.

One area where implementation lagged slightly behind planned targets was in the disbursement of project funds. According to project plans, the $3.5 million project was to be completed by June 1986. As of June 30, 1985, $2,013,822 had been expended which was about $445,677 short of projected expenditures. The USAID is aware of this problem and has taken steps to accelerate disbursements expanding the use of project funds for new home construction and increasing the number of PVO's participating in the project.

In our opinion, an effective system for measuring project results was established; however, the system can be improved by including procedures for reporting subloans in arrears so the USAID and the Institute can effectively monitor subloan delinquencies.

PVO compliance with provisions of the AID Project Agreement had not been satisfactory. The PVOs made many ineligible loans or had not used project funds for intended purposes. PVO officials were either new at their jobs or lacked the proper training to administer the program. Although many sub-loans did not comply with program eligibility requirements, they were made within the spirit of the program to help the rural poor and improve housing. Also, PVO officials indicated their willingness to correct deficiencies and manage loan funds as required in the Institute/PVO loan agreements.

Although the Institute had established a system to monitor compliance with project requirements, the scope of the program reviews done by the Institute's auditors was too limited to effectively identify all areas of non-compliance.

This report includes eight recommendations to improve the Institute and PVO administration of the project. USAID/Honduras started corrective actions on all audit recommendations while the audit was in process. As a result of these actions, two recommendations will be closed upon publication of this report.

Office of the Inspector General

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PART I - INTRODUCTION

A. Background

On June 5, 1981, USAID/Honduras (USAID) and the Government of Honduras (Government) signed a project agreement for a Rural Housing Improvement project for $2.5 million. On June 29, 1984 the project agreement was amended to increase project funding to a total of $3.5 million of which $3.3 million is loan-funded and $200,000 is grant-funded. The goal of this project was to provide healthier and more comfortable living conditions for poor rural families.

The purpose of the project was to establish a system to make sustained improvements in the housing conditions of the rural poor. At the completion of the project, the National Housing Institute (Institute) was to have developed its capacity to provide technical and financial assistance to participating project intermediaries (PVOs).

The project was to enable the Institute, the implementing agency, to finance home improvement sub-loans and new home construction for low-income rural families. The Institute was to channel AID's funds to various intermediary organizations, including private voluntary organizations, public sector institutions, cooperatives, savings and loan institutions, and private entrepreneurs that would, in turn, lend the funds to individual borrowers, community associations or homeowner associations.

The Institute and the borrowers were to contribute $1,530,000 to the project. The Institute was to finance approximately $400,000 in project administrative costs not included in the budget. The borrowers were to contribute their downpayments (20% of loan amount) and their self-help labor (22%), estimated at $530,000 and $600,000, respectively, to improve their homes.

By the end of the project, the USAID expected that over 8,000 sub-loans would have been made with the first use of loan funds.

The $200,000 grant was to finance the services of an Institute/USAID project coordinator and short-term technical assistance. Loan funds totalling $2,279,000 had been earmarked for home improvements and $400,000 for new home construction. The remaining $621,000 in loan funds would finance limited commodities for the Institute and institution - building activities for the Institute, intermediaries, and participating community groups.

The original estimated completion date for the 60-month project was June 1, 1986. As of June 30, 1985, $2,013,822 had been expended under the project (see Exhibit 1).

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa performed an audit of the rural housing improvement project. The audit covered activities and expenditures (as above) during the period from May 14, 1982 through June 30, 1985. We reviewed compliance with the project requirements for the home improvement credit component of the project and evaluated overall project results.

Our specific audit objectives were to determine whether:

- the project had achieved the planned level of results,
- USAID/Honduras and the Honduras National Housing Institute (Institute) had established an effective system for measuring project results,
- the PVOs had used project funds for intended purposes,
- the Institute had established an effective system to monitor PVO compliance with project requirements.

The audit included a review of pertinent files and interviews with officials of USAID/Honduras, the Institute, the PVOs, and the beneficiaries of the project. To verify compliance with project requirements for the home improvement subloan component of the project, five of 17 PVOs participating in the program were visited. At each PVO visited the accuracy of accounting books and records were reviewed and ten to twelve subloans were tested to determine compliance with established eligibility criteria. Our audit did not include a review of new home construction, technical assistance or institution building components of the project. This audit was made in accordance with generally accepted government audit standards.

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PART II - RESULTS OF AUDIT

The project had basically achieved its planned level of results. For example, 7,978 sub-loans out of 8,000 projected sub-loans had been made as of June 30, 1985. Also, prior to this project, rural families had not had any dealings with local banks. As a result of collection practices established by one participating PVO, Hermandad de Honduras, its beneficiaries had to deal directly with local banks. This new-found relationship stimulated an interest for savings accounts and understanding of the importance o timely loan repayment. Prior to this project, the PVOs main source of funds were donations from abroad for which they did not always have to maintain an accounting system for the funds donated. Because the funds received from the Institute under the AID Project Agreement were in the form of loans, the PVOs had to institute accounting systems to account for the use of these funds. The Institute provided training in bookkeeping, thereby also benefiting other parallel projects being carried-on by the PVOs. Moreover, the beneficiaries were making badly needed improvements to their houses such as putting concrete floors and permanent roofs where none existed previously. The improvements have made the homes more livable for the beneficiaries, both physically and psychologically.

One area where project implementation has lagged slightly was in the rate of disbursements. According to project plans, the $3.5 million project was to be completed by June 1, 1986. As of June 30, 1985, $2,013,822 had been expended, or about $445,677 short of projected expenditures as of the same date. The USAID was aware of this problem and has taken steps to accelerate the expenditure of money by expanding the use of project funds for new home construction and increasing the number of PVO's participating in the project.

In our opinion, an effective system for measuring project results had been established; however, the system could be improved by including procedures for reporting subloans in arrears, so the USAID and the Institute can effectively monitor sub-loan delinquencies, and, thereby, the PVOs' management of their loan portfolios.

PVO compliance with provisions of the AID Project Agreement was not satisfactory. We found many instances where the PVOs made ineligible loans or had not used project funds for intended purposes. PVO officials were either new at their jobs or lacked the proper training to administer the program. Although many sub-loans did not comply with program eligibility requirements, most were made within the spirit of the program to help the rural poor and improve housing. Also, PVO officials indicated their willingness to correct these past practices and to administer the funds as required in the Institute/PVO loan agreements.

The Institute had established a system to monitor compliance with project requirements, but the scope of the reviews done by the Institute's auditors was too limited to effectively identify all areas of non-compliance.

A. Findings and Recommendations

1. PVO Administration of Sub-Loans

A substantial number of the sub-loans made by the five PVOs visited were not eligible under the terms of the program (see Exhibit 2). The loan agreements between the Institute and the PVOs required that the in-kind sub-loans be made to low-income families to improve their houses. Also, the Institute/PVO loan agreements required that the houses to be improved were not to have more than two rooms and that the income of the families receiving sub-loans would be within certain limits. Ineligible sub-loans were made: (a) for purposes other than improving houses, e.g., for the purchase of school desks; (b) to more than one member of a family; c) in the form of cash; d) to build new houses; e) to improve unoccupied houses; and f) to improve middle income housing. Although these sub-loans did not comply with the eligibility requirements of the program, many of the loans were made within its spirit. The AID project agreement authorized some funds for new home construction; however, none of the loan agreements between the Institute and the PVOs visited authorized funds for that purpose. These discrepancies occurred because the PVO officials were not properly trained in the administration of the sub-loan program and had not established the controls necessary to comply with program requirements. Another contributing factor was that the Institute's audits of PVO sub-loan portfolios did not include a procedure to verify the eligibility of the borrowers. As a result, $23,034 (L.46,068) in project funds managed by the PVOs we visited were not available to finance what was intended under the program.

Recommendation No. 1

We recommend that USAID/Honduras obtain evidence that the National Housing Instititue has:

a) required all participating Private Voluntary Organizations to prepare and use checklists to verify compliance with the eligibility criteria before awarding sub-loans to beneficiaries,

b) scheduled a training course for loan administrators and promoters employed by organizations participating in the project to familiarize them with the application of the criteria contained in loan agreements between the National Housing Institute and program intermediaries,

c) reviewed and amended its loan agreements as appropriate with participating Private Voluntary Organizations to give them flexibility to make sub-loans for new house construction, within mutually agreed upon limits,

d) established formal written criteria defining the income eligibility of project beneficiaries,

e) included verification of beneficiary eligibility as an internal audit objective in future reviews,

f) obtained refunds from Asociacion San Jose Obrero in the amounts of $1,875 (L. 3,750) for those sub-loans made for the purchase of 72 student desks, and $321 (L. 642) from Hermandad de Honduras for those sub-loans made to fence two sugar cane fields, and

g) prepared and sent to all agencies working with the project a circular outlining the established eligibility criteria. Compliance with the criteria will be noted in periodic Institute field reports.

Discussion

The project sought to improve the rural housing of low income families by providing funds to intermediaries for the purpose of making sub-loans in the form of materials to beneficiaries for the improvement of their existing houses.

Our review of 63 sub-loans randomly selected from a universe of 1,599 loans made by five PVOs disclosed that 45 sub-loans (71 percent of those reviewed) were not eligible under the terms of the program (see Exhibit 2). The loan agreement between the Institute and the PVOs required that the sub-loans be used exclusively for home improvements. Although these sub-loans did not comply with program eligibility requirements, many of the loans were made within the spirit of the program. Amendment No. 1 to the AID project agreement authorized $400,000 for new home construction; however, none of the loan agreements between the Institute and the PVOs we visited authorized funds for this purpose. As of June 30, 1985, funds for construction purposes had not yet been assigned to PVOs. Ineligible sub-loans were made:

- for purposes other than improving houses such as for the purchase of school desks,
- to more than one member of a family,
- in the form of cash,
- to improve middle income housing,
- to build new houses, and
- to improve unoccupied houses.

These discrepancies occurred because the PVO officials were not properly trained in the administration of the sub-loan program and had not established the controls necessary to comply with requirements of the program. Another contributing factor was that the Institute's audits of the PVOs did not include a procedure to verify the eligibility of subloans.

As a result, $23,034 (L.46,068) in project funds used for ineligible purposes (an average of $4,607 at each PVO) were not available to finance what was intended under the program.

Funds Not Used For Project Purposes - Two PVOs made five sub-loans for purposes other than improving houses. Asociacion San Jose Obrero made three sub-loans for $1,875 (L.3,750) to the Instituto Tecnico Libertad, a private school, to buy 72 student desks. Also, Hermandad de Honduras made two sub-loans for $321 (L.642) to improve homes and to fence two sugar cane fields.

The Institute/PVO loan agreements state that, "... sub-loans to the beneficiaries, are to be used only and exclusively for financing the costs of improvements, expansion or reconstruction of their houses...." Also, the an agreements state: "When the Institute, through inspections made or through other information, determines that the Implementing Unit (PVO) has received disbursements from the line of credit for purposes other than to finance sub-loans according to the terms and conditions of the agreement, the Institute would notify the Implementing Unit (PVO) to refund the corresponding amounts...."

According to the director of PVO Asociacion San Jose Obrero, its loan administrator was new and had not received proper training in the administration of sub-loans. In the case of PVO Hermandad de Honduras, the controls established in the loan agreement were not followed.

As a result, $2,196 (L. 4,392) were not used for sub-loans to beneficiaries as intended in the Institute/PVO loan agreements. Since the three sub-loans made by Asociacion San Jose Obrero to buy 72 student desks and the two sub-loans made by Hermandad de Honduras to fence two sugar cane fields were not within the letter or spirit of the program, the Asociacion should refund $1,875 (L.3,750) and Hermandad $321 (L. 642) to the Institute or restore such monies to their loan funds to be used for eligible project purposes.

Funds Used for Construction of New Houses - A total of 17 sub-loans were made to construct or finish new houses which were not authorized in the Institute/PVO loan agreements. While the sub-loans would be within the spirit of the AID Project Agreement -- to improve the living conditions of the rural poor -- technically, they were not within the scope of the Institute/PVO agreements.

According to the Institute's quarterly report of June 30, 1985, "For the development of the construction phase, the Project is contemplating an assignment of funds totalling $400,000 (L. 800,000) which will be utilized by those agencies which have successfully implemented the Rural Housing Improvement Project over 18 months." The AID Project Agreement authorized $400,000 for construction of new homes. However, the Institute/PVO loan agreements state only that, "Eligible beneficiaries should be groups or families living in houses subject to improvement...."

The PVOs made ineligible sub-loans because they did not follow the criteria established in the Institute/PVO loan agreements. As a result, $11,089 (L.22,178) in project funds were used for building or finishing new homes instead of improving existing homes.

According to USAID officials, the sub-loans were within the spirit of the agreement to improve the living conditions of the rural poor. In our opinion, if this type of sub-loan is to be authorized, the agreements should be amended to provide the flexibility to make this type of sub-loan when deemed justifiable by the PVOs.

Multiple Sub-Loans to the Same Family - Four PVOs made 12 sub-loans to more than one member of the same family to improve their homes.

According to the Institute/PVO loan agreements, families may receive one loan at a time for the maximum amount authorized. Once a sub-loan is paid-off, another sub-loan can be awarded to the same immediate family members.

These discrepancies occurred because PVO officials did not prepare and use checklists of the requirements of the Institute/PVO loan agreements to guide them in approving eligible loans. According to some PVO officials, they had not read the Institute/PVO loan agreement and had relied entirely upon past experiences in making sub-loans. Another contributing factor was that the Institute's internal auditors did not review for the eligibility of sub-loans in past reviews.

As a result, $6,680 (L.13,359) in the PVOs' project funds were loaned to families already having outstanding sub-loans, contrary to the Institute/PVO loan agreements.

Improved Houses Were Not Occupied by the Beneficiaries - Two PVOs (Cooperativa Pinalejo and Cooperativa FEHCIL) made five sub-loans to improve unoccupied houses. Pinalejo made two sub-loans to improve small houses of beneficiaries in the fields where they worked. The beneficiaries used these houses during working hours; however, they did not use the houses as their principal residences. The Cooperativa FEHCIL made three sub-loans to beneficiaries who did not occupy the improved houses. We could not determine why the houses were unoccupied.

The Institute/PVO loan agreements state that, eligible beneficiaries should be groups or families "living in houses subject to improvement...." Also, the agreements say that, "beneficiaries [must] reside at least for one year in the houses to be improved...."

The loan administrators did not follow the criteria established in the Institute/PVO loan agreements. As a result, $2,590 (L.5,180) in PVO project funds were used to improve unoccupied houses.

Cash Sub-Loans - Cooperativa Pinalejo made sub-loans in the form of cash to beneficiaries. Although we identified only one cash sub-loan in our sample, the Pinalejo loan administrator told us that the PVO made small cash loans when it did not have the materials on hand needed by beneficiaries. The cash payments were to be included as part of the sub-loans requested by the beneficiaries.

Both the AID Project Agreement and the Institute/PVO loan agreements were silent regarding cash loans. According to the Institute Project Coordinator, all sub-loans to beneficiaries were to be in the form of materials rather than cash. Furthermore, in the midterm evaluation of the project, the consultants recommended that, "the Project should continue to give loans in the form of construction materials and not in cash."

These cash loans were made because the PVO did not have on hand the materials needed by beneficiaries. As a result, the PVO could not be certain that the cash sub-loans were used for the improvement of beneficiaries' homes.

Improved House Exceeded The Criteria In Loan Agreement - Asociacion San Jose Obrero made one loan to a beneficiary owning a house valued at $30,000. The sub-loan was made to add a room to the house so the room could be rented to local students. Two pre-requisites of the Institute/PVOs loan agreement were that 1) the house to be improved would not have more than two rooms, 2) the family making the sub-loan would qualify as a low-income family. In our opinion, the family in question would not qualify as a low-income family.

We also verified the annual incomes of 41 borrowers at four of the five PVOs visited (see Exhibit 4). This analysis showed that four sub-loans were made to beneficiaries earning over $10,000 (L.20,000):

- The Federacion Hondurena de Cooperativas Industriales Limitada made one sub-loan to a family earning over $16,500 (L.33,000) annually and another sub-loan to a family earning over $12,500 (L.25,000). The husband in the first family was a dentist and the wife owned and operated a beauty shop. The second family owned about 35 head of cattle and approximately 204 acres of land. In addition, the wife owned and operated a small grocery store.

- The Asociacion Buena Fe also made sub-loans to a family owning a small business and earning over $15,500 (L.31,000) a year, and to another family owning a sugar cane field and earning over $12,500 (L.25,000) annually.

The Institute/PVO loan agreements stated that, "beneficiaries eligible under this project would have to be classified as low-income families."

The qualifications of sub-loan applicants as low-income families were to be determined by each PVO. However, the process used by the PVOs appeared to focus on whether the applicant would be able to pay-off the sub-loan rather than to determine whether the applicant's income was too high. In addition, the Institute/PVO agreements did not define what income level would qualify beneficiaries as low-income families.

As a result, four sub-loans were made to beneficiaries earning more than $10,000 annually and project funds in the amount of $2,229 (L.4,457) were not used for sub-loans to the more needy families.

The USAID project officer indicated to us that it would be difficult to establish realistic low-income criteria because the number of dependents among families varies. Documentation for another AID project (522-HG-008) provided median income figures for all urban areas that could be modified to establish low income crieteria. In addition, the Institute has developed an income formula to qualify borrowers that takes the number of family members into account.

Management Comments

USAID/Honduras took the following actions to implement Recommendation No. 1:

Parts (a) and (g) - On November 8, 1985, the Institute issued Circular No. 4 instructing the PVOs implementing the project eligibility criteria for the beneficiaries to be favored by the subloans.

Part (b) - The Institute submitted a schedule of training courses for loan administrators and promoters. The first course will be given during the 3rd and 4th of December, with 36 participants representing 18 PVOs.

Part (c) - The Institute and USAID/Honduras met to discuss in detail the amendment to the Loan Agreements between the Institute and PVOs, and decided to authorize the PVOs to give loans for new construction of homes, termination of construction, reparations, enlargements, and reconstruction. Such loans will not exceed a maximum of $500 (L.1,000) and no more than one loan will be made to a single family for the same dwelling. When the original loan balance is paid, the beneficiary can apply for a new loan. USAID/Honduras has prepared and is circulating for clearance a Project Implementation Letter to this effect.

Part (d) - On November 8, 1985, the Institute issued Circular No. 4 to the PVOs which specified the maximum family incomes for home improvement and construction subloans.

Part (e) - USAID/Honduras received a copy of the Institute's letter dated November 14, 1985, which was sent to the Chief of the Institute's Audit Office, requesting that the Institute's Audit Office verify that the eligibility criteria are being complied with when the PVOs assign loans to the beneficiaries.

Part (f) - USAID/Honduras has received a copy of the letter from the Asociacion San Jose Obrero stating that they are committed to the reimbursement of project funds that have been used for other purposes not stated in the project Agreement. USAID/Honduras has also received a copy of the letter from Hermandad de Honduras reimbursing the $321 (L.642).

<u>Office of Inspector General Comments</u>

All parts of Recommendation No. 1 except parts (c) and (f) are to be closed upon publication of this report because of the corrective actions described above.

2. PVO Loan Delinquency Rates

The five PVOs visited had a sub-loan delinquency rate of 14.5 percent on the value of loans outstanding as of June 30, 1985. The Institute/PVO loan agreements required the PVOs to collect from the beneficiaries all the costs attributable to the program. Some of the PVOs were reluctant to enforce established collection procedures because of low market prices on the crops raised by many beneficiaries. In addition, the Institute did not prepare and submit to the USAID delinquency reports that could have been used to monitor the repayment record of the beneficiaries. As a result, the high delinquency rate among the five PVOs visited could decapitalize the PVOs' loan funds if corrective action is not taken.

Recommendation No. 2

We recommend that USAID/Honduras obtain from the National Housing Institute:

a) regular sub-loan delinquency reports, and

b) evidence that participating Private Voluntary Organizations are enforcing their established collection procedures.

Discussion

As of June 30, 1985 the five PVOs visited had 1058 sub-loans outstanding for $495,610. Of the number of loans outstanding, 390 or 37 percent were delinquent in the amount of $71,861 or 14.5 percent of the total outstanding (see Exhibit 3).

The Institute/PVO loan agreements state that, "...the implementing unit agrees to adopt and maintain a credit policy that will ensure the Rural Housing Improvement Program be self-financed and agrees to recuperate from the beneficiaries all of the costs attributable to the Program...."

The majority of the sub-loans in arrears were made to local farmers whose livelihood depended solely on the crops they planted. Although, the farmers produced enough crops to make a profit, poor local economic conditions created very low market prices for their crops and the farmers could not break even. The PVOs had established good collection policies to recuperate payments from the beneficiaries but due to low market prices on the crops brought to market by the beneficiaries, some of the PVOs were reluctant to enforce their collection policies. Although, the Institute was not required to prepare and submit to USAID delinquency reports, they could have been used by USAID to monitor the repayment record of the beneficiaries.

When repayments of these sub-loans remain outstanding for such long periods of time, the PVOs' reflow of funds available for sub-loans to other beneficiaries is reduced.

Management Comments

USAID/Honduras took the following actions to resolve Recommendation No. 2:

Part (a) - USAID/Honduras obtained the Institute's first delinquency report through October 31,1985.

Part (b) - The Institute's loan administrators have been instructed to show special interest in the implementation of collection procedures. According to the Institute Manager, this action will be carried out by the Institute through its Department of Internal Audit.

Office of Inspector General Comments

Part (a) of Recommendation No. 2 is to be closed upon publication of this report because of corrective actions taken by USAID/Honduras as described above.

3. Project Funds Diverted to Other PVO Uses

Three PVOs used $62,572 (L.125,144) in project funds to make loans for other purposes within their organizations. The Institute/PVO loan agreements require that sub-loans be made exclusively for improving the homes of project beneficiaries. The PVOs used project funds for other purposes because they needed the cash to keep other projects operating. As a result, $62,571 (L.125,144) in project funds were not available to make home improvement sub-loans as intended in the loan agreement.

Recommendation No. 3

We recommend that USAID/Honduras obtain evidence from the National Housing Institute that it has collected refunds from the following organizations:

. Asociacion San Jose Obrero	-	$52,687	(L.105,374)
. Asociacion Buena Fe	-	$ 384	(L. 767)
. Federacion Hondurena de Cooperativas Industriales Limitada	-	$ 9,500	(L. 19,000)

Discussion

Three PVOs (Asociacion San Jose Obrero, Federacion Hondurena de Cooperativas Industriales Limitada (FEHCIL) and Asociacion Buena Fe) loaned project funds for other purposes within their organizations.

Asociacion San Jose Obrero used $52,011 (L.104,022) in project funds to buy materials needed under another project because reimbursement of funds thereunder by its sponsor, the Inter-American Development Bank (IDB), had been delayed. The borrowed funds were to be returned to the project upon receipt of reimbursement of funds from IDB. The PVO received a check for $25,000 (L.50,000) from IDB during our visit. In addition to the funds loaned to other projects, the PVO had loaned project funds totaling L.1,350 ($675) to clients, PVO officials and employees.

PVO Federacion Hondurena de Cooperativas Industriales Limitada (FEHCIL) used $9,500 (L.19,000) in project funds to cover the balance owed on the purchase of pelts under an IDB-financed project. The PVO used project funds as a loan to the IDB project to keep the affiliated cooperatives needing the pelts in operation pending reimbursement from IDB.

PVO Asociacion Buena Fe sold construction materials bought with project funds over-the-counter to anyone paying cash for them. As of June 30, 1985, the PVO had made cash sales of $3,668 (L.7,336), but had replaced all project materials except for $383 (L.767). The PVO director agreed to return this amount to the project loan fund. The PVO made the cash sales as a convenience to the local residents in order to create a good working relationship between the PVO and the community.

The Institute/PVO loan agreements state that, "the line of credit available to the PVOs was to make sub-loans to the beneficiaries, to be utilized only and exclusively for financing the costs of improvements...." The agreements did not contain any provisions allowing the use of funds for non-project activities.

Institute's auditors had identified San Jose Obrero's problem of lending funds for other PVO activities in their January 10, 1985 report. The auditors determined at that time that $37,884 (L.75,767) of the PVO's project funds were used to finance other activities.

As a result of these diversions for other purposes within the PVOs, $62,571 (L.125,141) of project funds were not available to make home improvement sub-loans as intended by the Institute/PVO loan agreements.

Management Comments

In response Recommendation No. 3 USAID/Honduras advised us that the Asociacion San Jose Obrero had already refunded $26,250 (L.52,500) to the project. Also, that the Federacion Hondurena de Cooperativas Industriales Limitada and the Asociacion Buena Fe have refunded the recommended amounts. According to USAID/Honduras, the Asociacion San Jose Obrero has promised to refund the pending balance by December 31, 1985.

4. Purchase of Automobile, Motorcycle and Machinery

PVO Asociacion San Jose Obrero used $20,786 (L.41,571) of the project loan funds to purchase an automobile, a motorcycle and machinery to make bricks. Also, the Asociacion used $720 (L.1,441) in project funds to purchase automobile insurance. The PVO believed that they could use project funds for these costs because these items were to be used for project purposes. However, the loan agreements between the Institute and the PVOs require the PVOs to make sub-loans to beneficiaries only and exclusively to make home improvements. As a result, $21,506 (L.43,012) in project funds were not available to beneficiaries to improve their houses.

Recommendation No. 4

We recommend that USAID/Honduras obtain from the National Housing Institute evidence that Asociacion San Jose Obrero has refunded $21,506.

Discussion

On August 15, 1984, Asociacion San Jose Obrero purchased a motorcycle valued at $1,536 (L.3,071) and on March 27, 1985 an automobile valued at $10,250 (L.20,500). Also, the Asociacion used $720 (L.1,441) of project funds to buy automobile insurance. Both vehicles were obtained for the purpose of visiting beneficiaries and inspecting the work being performed with project funds. On July 20, 1985, the PVO purchased machinery for making bricks valued at $9,000 (L.18,000) for the purpose of selling bricks to beneficiaries at lower than market cost.

PVO officials believed that it was appropriate to use project funds to finance these costs because the items were to be used for project purposes.

However, the Institute/PVO loan agreement states that, "a line of credit for $150,000 (L.300,000) was available to the PVO to make sub-loans to the beneficiaries, to be utilized only and exclusively for financing the costs of improvements, expansion or reconstruction of their houses...."

While the intent of obtaining these items was to lessen project costs, the immediate result was to decapitalize the PVO's project loan fund. In our opinion, these items should be financed by the Asociacion and not by the project.

Management Comments

In response to our audit finding, USAID/Honduras informed us that the Asociacion San Jose Obrero had agreed to refund $21,506 by December 31, 1985.

5. Administrative and Training Costs Charged to Project

As of June 30, 1985, four PVOs had charged $33,143 (L.66,286) in administrative costs to the Rural Housing Improvement Project and one PVO had charged $2,140 (L.4,280) in training costs. These costs were charged to project funds because project loan administrators were not aware that the costs could not be charged against project funds. Also, the Institute's internal audits had not included this issue as part of their reviews. According to an Institute/PVO loan agreement and the Project Paper, project funds were not to be used to pay administrative costs. In addition, the AID Project Agreement makes the Institute responsible for training services. As a result, PVO project loan funds were decapitalized by $35,283 (L.70,566).

Recommendation No. 5

We recommend that USAID/Honduras obtain from the National Housing Institute evidence that the Institute has:

a) collected refunds from the following organizations:

. Asociacion San Jose Obrero	$26,418	(L.52,837)
. Federacion Hondurena de Cooperativas Industriales Limitada	$ 4,863	(L. 9,725)
. Asociacion Buena Fe	$ 1,862	(L. 3,724)
. Cooperativa Pinalejo	$ 2,140	(L. 4,280)

b) included procedures in its internal audits to verify that administrative and training costs are financed by the intermediaries themselves.

Discussion

As of June 30, 1985, four PVOs had charged $33,143 (L.66,286) in administrative costs to the project and one PVO had charged $2,140 (L.4,280) in training costs as follows:

- Asociacion San Jose Obrero used $26,418 (L.52,837) in project funds to pay for salaries of employees, administrative services, honoraria, and various other services.

- Federacion Hondurena de Cooperativas Industriales Limitada used $4,863 (L.9,725) in project funds to pay for the administrative costs to the project and the Asociacion Buena Fe used $1,862 (L.3,724) for the same purpose.

- Cooperativa Pinalejo used $2,140 (L.4,280) in project funds for a training course for bricklayers. The training course was to be repaid by a group of bricklayers but we did not see any evidence of repayment.

The Institute/PVO loan agreements state that, "...the implementing unit cannot use under any circumstances funds from the line of credit to pay administrative costs...." Also, the AID Project Agreement states that, "Institute will be responsible for ensuring the provision of this assistance by: ...contracting with the Professional Training Institute of Honduras (INFOP) for training services in both basic construction techniques and local materials production."

The PVOs charged administrative and training costs to project funds because loan administrators were not aware that these costs could not be charged against project funds.

The Project Paper states that, "...subloan administration and bad debts will have to be recovered through a combination of adding those costs to the price of the materials financed and charging interest on the subloans."

According to the semiannual report (October 1984-March 1985) prepared by USAID/Honduras, "a financial evaluation of the project was carried out to determine the costs of operating the rural housing improvement program, both to the Institute and to the participating intermediaries. The evaluation showed that the intermediaries, which are charging an average of 20 percent on their loans, are recuperating their administrative costs." This is a clear indication that the administrative costs should be paid from the interest generated from the sub-loans and not from the project loan funds.

Charging the administrative and training costs to project funds effectively decapitalized PVO loan funds by $35,283 (L.70,566).

Managements Comments

USAID/Honduras informed us that they took the following corrective actions in response to Recommendation No. 5.

Part (a) - All PVO's except San Jose Obrero have refunded the recommended amounts.

Part (b) - The Institute issued instructions to its Internal Audit Department to include procedures in its internal audit to verify that administrative and training cost are financed by the PVOs themselves.

Office of Inspector General Comments

Based on corrective actions described above, part (b) of Recommendation No. 5 is closed upon publication of this report.

6. Legal Status of Asociacion Buena Fe

PVO Asociacion Buena Fe had not been recognized by the Government of Honduras as having legal status in the country. According to the AID project agreement, an intermediary, among other requirements, must have legal status (personeria juridica). The Institute, anticipating favorable action on the Asociacion's applications for legal status by the President of Honduras, signed the loan agreement with the Asociacion, thus making it eligible to receive AID funds. The acceptance of the PVO by the Institute was premature and contrary to the AID project agreement.

Recommendation No. 6

We recommend that USAID/Honduras obtain evidence from the National Housing Institute that additional disbursements of funds to the Asociacion Buena Fe have been suspended until the Asociacion's legal status is resolved by the Government of Honduras.

Discussion

The local Ministry of Health issued a decree to the Asociacion Buena Fe which was published in the official government newspaper (La Gaceta) authorizing the Asociacion to control real property and other articles introduced into the country. Because of this decree and the fact that the Asociacion's application for legal status had been sent to the President, the Institute anticipated that the President would give the Asociacion its legal status in Honduras. Thus, the Institute signed the loan agreement with the Asociacion, making it eligible to receive AID funds. However, the application for legal status was returned to the Asociacion without Presidential approval because of certain procedural errors.

The AID Project Agreement stated under Section II. A. "Institute - Intermediary Relationships. The Institute's criteria for acceptance of potential intermediaries are that the organization must, inter-alia, have legal status (personeria juridica)."

According to the Institute's Project Coordinator, the loan agreement between the Institute and Asociacion Buena Fe was signed because he had been assured by the Minister of Finance that legal status would be granted to the Asociacion. Also, he heard a radio announcement that the President had signed papers granting legal status to a number of organizations. The Institute Project Coordinator assumed that Asociacion Buena Fe was among the organizations granted legal status.

Because the Asociacion was operating under a decree which did not grant it legal status, it was not entitled to receive funds from an agency of the Honduran government. Thus, approval of the PVO by the Institute was premature and contrary to the AID project agreement.

The Asociacion has re-submitted its application to the President requesting legal status. However, because of the proximity of national elections the process for granting legal status has been delayed.

Management Comments

In response to Recommendation No. 6, the Institute sent a letter to Asociacion Buena Fe suspending additional disbursement to the PVO until their legal status is resolved by the Government.

Office of Inspector General Comments

Based on corrective actions taken as described above, Recommendation No. 6 is closed upon publication of this report.

7. PVO Books and Records

PVO loan accounting books and records were not maintained adequately. The books and records should be maintained in accordance with generally accepted accounting principles, applied in a consistent manner. According to the PVOs' directors, this problem occurred because administrative and accounting personnel were either new at their jobs or had not been given adequate training. As a result, the accounting for project funds was inadequate, cumbersome and not uniformly applied.

Recommendation No. 7

We recommend that USAID/Honduras obtain from the National Housing Institute evidence that it has established:

a) a standardized loan accounting and reporting system for participating Private Voluntary Organizations, and

b) a training program schedule in accounting and bookkeeping for personnel of the Private Voluntary Organizations.

Discussion

In general, PVO loan accounting books and records were not maintained adequately. For example, beneficiaries' loans were not numbered consecutively, monthly summaries were not made, numerous entries were originally posted in ink and later erased, documentation was missing and some of the beneficiaries' loan folders could not be found.

At one PVO, 16 sub-loans were not posted and partial payments on sub-loans were maintained on a separate sheet of paper, and the amounts were not posted to the borrowers' loan accounts. At another PVO, the amount of sub-loans made did not reconcile with the general ledger.

The Institute/PVO loan agreements stated that the implementing unit would "maintain accounting books, records, documents and other evidence of the use of project funds demonstrating and reflecting properly all the transactions that had taken place under this agreement. The books and records should be maintained in accordance with accepted accounting principles, applied in a consistent manner."

A contributing factor to this problem was that administrative and accounting personnel were either new at their jobs or had not received adequate training. Another factor was that a standardized accounting system had not been established. As a result, accounting for project funds was inadequate, cumbersome and not uniformly applied among the PVOs.

The problem with maintaining books and records at the PVO level was well known. Although the Institute's auditors had raised this issue previously, it still persists. The Institute has provided basic bookkeeping courses to PVO personnel in the past and some improvements had been made. According to the Institute Project Coordinator, an accountant has been contracted to spend a week at each PVO location to establish a simplified accounting system and train personnel in the maintenance of the system. After the establishment of the system, the accountant will return to each PVO location for two additional days to ensure that the new system is being implemented properly.

Managements Comments

USAID/Honduras has started the following action to implement Recommendation No. 7:

The Institute contracted [a qualified accountant] to establish a standardized loan accounting and reporting system for the Private Voluntary Organizations as well as to provide training in bookkeeping and accounting procedures to PVO personnel. The system has been designed and it is expected to be implemented in all PVOs by November 30, 1985. The Institute has also prepared a schedule to train PVO personnel in the use of the new system.

Office of Inspector General Comments

Based on corrective actions described above part (b) of Recommendation No. 7 is closed upon publication of this report.

8. Downpayments from Beneficiaries

Two of the five PVOs visited were not enforcing the project's 20 percent downpayment requirement. The Institute/PVO loan agreements require borrowers to make a cash downpayment equal to 20 percent of the sub-loan amount. The two PVOs did not enforce the 20 percent downpayment requirement in order to make more sub-loans to borrowers. Also, the Institute's reviews did not include verification of the downpayment requirement. As a result, an important provision of the Institute/PVO loan agreements was not being implemented.

Recommendation No. 8

We recommend that USAID/Honduras:

a) review the 20 percent downpayment provision in the loan agreements and obtain enforcement or modify it, as appropriate, and

b) obtain evidence from the National Housing Institute that its program reviews include procedures to verify compliance with the 20 percent rule or a modified alternative.

Discussion

Two of the five PVOs visited did not collect the required 20 percent downpayment from beneficiaries prior to making loans. Hermandad de Honduras did not enforce the 20 percent downpayment requirement because it was making smaller sub-loans to beneficiaries and the no downpayment policy provided an incentive for beneficiaries to apply for loans. The other PVO (FEHCIL) did not have the same policy but instead would lend beneficiaries the 20 percent downpayment, which the beneficiaries would have to repay first.

The Institute/PVO agreements stated that "The beneficiaries will give the Implementing Unit a downpayment of not less than 20 percent of the cost of the improvements prior to the Implementing Unit's making the sub-loan disbursement...."

The two PVOs claimed that the 20 percent downpayment requirement was not a guaranty that the borrowers would repay their sub-loans. Also, without the downpayment requirement, the PVOs were able to make more sub-loans because potential borrowers did not have any up-front costs. For these reasons, the USAID Project Officer indicated that other alternatives might be considered as a loan guaranty.

As a result, the 20 percent downpayment provision in the Institute/PVO loan agreement was not always being implemented.

Management Comments

USAID/Honduras took the following actions to implement Recommendation No. 8:

The Institute and USAID/Honduras agreed that the provision of 20 percent downpayment will remain as is, except for Hermandad de Honduras, due to the history of the project with this PVO and to the success of this organization in the recovery of loans. The Institute will send USAID/Honduras a letter requesting this exception. The letter received from the Institute waives the 20 percent downpayment rule for Hermandad de Honduras and attests that FEHCIL is currently enforcing the 20 percent downpayment rule.

USAID/Honduras has received a copy of the l ter as evidence that the Institute's Audit Office has included in its periodic reviews the verification of the 20 percent downpayment provision and that verification will be included in future reports.

Office of Inspector General Comments

Recommendation No. 8 is to be closed upon publication of this report based on corrective actions described above.

B. Compliance and Internal Control

Compliance - Audit results show that Private Voluntary Organizations (PVOs) were not generally complying with the criteria established in the loan agreements between them and the Honduran Housing Institute (Institute). PVO officials were either new at their jobs or lacked the proper training in administering the loan program. Training the officials responsible for administering the loan program and improving monitoring by the Institute will reduce the following compliance exceptions:

- funds not used for project purpose,
- funds used for construction of new houses,
- multiple sub-loans to beneficiaries,
- funds used to improve houses which remained unoccupied,
- subloans made in the form of cash,
- funds used to improve middle-income houses,
- accounting books and records not adequately monitored,
- cash downpayment not enforced,
- collection procedures not enforced, and
- ineligible PVO accepted into program.

Internal Control - Except as noted below, internal controls were found to be appropriate and operating in satisfactory manner.

- Institute had not established effective procedures to monitor PVO compliance with all program requirements.
- Institute had not set-up an effective reporting system to help itself and the USAID monitor subloan delinquencies.

C. OTHER PERTINENT MATTERS

PVO Hermandad de Honduras has been more successful in collecting sub-loan payments than most of the other PVOs making sub-loans (see Exhibit 3) because they established and followed effective collection policies.

Hermandad had adopted a policy of requiring project beneficiaries to repay their sub-loans through a local bank. The bank provided payment statements to the PVO and a list of beneficiaries that had not made their payments on the due dates. The bank charged the PVO one percent for its services. The PVO updated the beneficiaries' loan accounts when the statements were received and sent notices to those that were late in making payments. A third notice to the beneficiaries informed them that their account would be turned over to a local justice for collection action. This prompted the beneficiaries to make timely payments because they did not want to face the local justice.

The policy described above could be replicated at other PVOs participating in the project. We have thus suggested that USAID/Honduras, in consultation with the Institute, evaluate establishing Hermandad's collection policy at other PVOs.

AUDIT OF
RURAL HOUSING IMPROVEMENT PROJECT
USAID/HONDURAS (522-0171)

PART III - EXHIBITS AND APPENDICES

Exhibit 1

USAID/HONDURAS

PROJECT EXPENDITURES

AS OF JUNE 30, 1985

(522-0171)

Element	Loan	Grant	Total
Housing Improvement Credit	$1,625,479	$117,802	$1,743,281
Training	152,382	-	152,382
Commodities	118,159	-	118,159
Totals	$1,896,020	$117,802	$2,013,822

Exhibit 2

ANALYSIS OF INELIGIBLE SUBLOANS

PVOs	Funds Not Used for Project Purposes	Funds used for Construction of Houses	Two Loans To the Same Family	Beneficiary Income Was Too High	Improved Houses Were Not Occupied by Beneficiaries	Cash Loans	Improved Houses Exceeded the Criteria In Loan Agreement	Total
Asociacion San Jose Obrero	3	5	4	-	-	-	1	13
Cooperativa Pinalejo	-	-	3	-	2	1	-	6
Hermandad de Honduras	2	1	-	-	-	-	-	3
Asociacion Buena Fe	-	3	4	2	-	-	-	9
Cooperativa FEHCIL	-	8	1	2	3	-	-	14
TOTAL	5	17	12	4	5	1	1	45

ANALYSIS OF DELINQUENT SUBLOANS

PVOs	Number of Payments In Arrears 1/ From 1-10	11-20	21-30	31-36	Number of Sub-Loans Outstanding	Number of Sub-Loans In Arrears	Percentage of Sub-Loans in Arrears	Total Value of Payments In Arrears	Total Value Outstanding Sub-Loans	Percentage of Value In Arrears
Hermandad de Honduras	99	14	9	1	370	123	33%	L. 29,528.93	L. 259,849.43	11.0%
Cooperativa FEMCIL	24	49	12	0	238	85	36%	L. 53,809.56	L. 332,215.92	16.2%
Asociacion San Jose Obrero	134	-	-	-	221	134	61%	L. 31,534.25	L. 232,358.22	13.6%
Cooperativa Piralejo	43	2	-	-	124	45	36%	L. 28,677.66	L. 114,379.02	25.0%
Asociacion Buena Fe	3	-	-	-	105	3	.03%	L. 171.05	L. 52,417.31	.33%
TOTAL	303	65	21	1	1058	390	37%	L. 143,721.45 ($ 71,860.73)	L. 991,219.90 ($ 495,609.95)	14.5%

1/ Payment periods varied from one to several months.

Exhibit 3

Exhibit 4

INCOME LEVELS OF SELECTED BENEFICIARIES

	PVOs				
Annual Income	San Jose Obrero	Pinalejo	FEHCIL	Buena Fe	Totals
$ 200-500	6	2	1	0	9
$ 500-1,000	5	1	1	2	9
$ 1,000-1,500	1	0	3	0	4
$ 1,500-2,000	0	3	1	0	4
$ 2,000-2,500	0	2	1	1	4
$ 2,500-3,000	0	1	2	2	5
$ 3,000-5,000	0	0	0	0	0
$ 5,000-10,000	1	0	0	1	2
$10,000-15,000	0	0	1	1	2
$15,000-17,500	0	0	1	1	2
Totals	13	9	11	8	41

LIST OF RECOMMENDATIONS

Page

Recommendation No. 1 — 5

We recommend that USAID/Honduras obtain evidence that the National Housing Institute has:

a) required all participating Private Voluntary Organizations to prepare and use checklist to verify compliance with the eligibility criteria before awarding sub-loans to beneficiaries,

b) scheduled a training course for loan administrators and promoters employed by organizations participating in the project to familiarize them with the application of the criteria contained in loan agreements between the National Housing Institute and program intermediaries,

c) reviewed and amended its loan agreements as appropriate with participating PVOs to give them flexibility to make sub-loans for new house construction, within mutually agreed upon limits,

d) established formal written criteria defining the income eligibility of project beneficiaries,

e) included verification of beneficiary eligibility as an internal audit objective in future reviews,

f) obtained refunds from Asociacion San Jose Obrero in the amounts of $1,875 (L.3,750) for those sub-loans made for the purchase of 72 student desks, and $321 (L.642) from Hermandad de Honduras for those sub-loans made to fence sugar cane fields, and

g) prepared and sent to all agencies working with the project a circular outlining the established eligibility criteria. Compliance with the criteria will be noted in periodic Institute field reports.

Page

Recommendation No. 2 12

We recommend that USAID/Honduras obtain from the National Housing Institute:

a) regular sub-loan delinquency reports, and

b) evidence that participating Private Voluntary Organizations are enforcing their established col ction procedures.

Recommendation No. 3 14

We recommend that USAID/Honduras obtain evidence from the National Housing Institute that it has collected refunds from the following organizations:

. Asociacion San Jose Obrero	- $52,687	(L.105,374)
. Asociacion Buena Fe	- $ 384	(L. 767)
. Federacion Hondurena de . Cooperativas Industriales Limitada	-$ 9,500	(L. 19,000)

Recommendation No. 4 16

We recommend that USAID/Honduras obtain from the National Housing Institute evidence that Asociacion San Jose Obrero has refunded $21,506.

Recommendation No. 5 17

We recommend that USAID/Honduras obtain from the National Housing Institute evidence that the Institute has:

a) collected refunds from the following organizations:

. Asociacion San Jose Obrero	$26,418	(L.52,837)
. Federacion Hondurena de Cooperativas Industriales Limitada	$ 4,863	(L. 9,725)
. Asociacion Buena Fe	$ 1,862	(L. 3,724)
. Cooperativa Pinalejo	$ 2,140	(L. 4280)

b) included procedures in its internal audits to verify that administrative and training costs are financed by the intermediaries (PVOs) themselves.

APPENDIX 2

REPORT DISTRIBUTION

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