

AUDIT OF USAID/COSTA RICA'S
NORTHERN ZONE INFRASTRUCTURE
DEVELOPMENT PROJECT (NO. 515-0191)

Audit Report No. 1-515-88-06
January 20, 1987

AGENCY FOR INTERNATIONAL DEVELOPMENT

OFFICE OF THE REGIONAL INSPECTOR GENERAL

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January 20, 1988

MEMORANDUM

TO : USAID/Costa Rica Director, Carl Leonard
FROM : RIG/A/T, *Conroy N. Gothard*
SUBJECT: Audit of USAID/Costa Rica's Northern Zone Infrastructure
Development Project (No. 515-0191)

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of USAID/Costa Rica's Northern Zone Infrastructure Development project (No. 515-0191). Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains two recommendations. Both recommendations are resolved, and will be closed when the required actions have been completed. Please advise me within 30 days of the actions taken to implement the two report recommendations.

I appreciate the cooperation and courtesy extended to my staff during the audit.

EXECUTIVE SUMMARY

The purpose of the Northern Zone Infrastructure Development project was to provide a basis for the efficient and equitable development of the project area, located in northwestern Costa Rica on the border with Nicaragua. The largest project component was to finance 152 kilometers of all-weather road. Three smaller components were to finance: village-level infrastructure projects such as schools and community centers; feasibility studies and pilot projects; and land purchases and the provision of land titles. The project agreements were signed on July 29, 1983, and the project assistance completion date had been extended one year to April 30, 1988. The \$20.8 million project budget included \$14.7 million in AID loan and grant funds and the equivalent of \$6.1 million in counterpart contributions. As of July 31, 1987 a total of \$16.2 million had been disbursed.

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results audit of the Northern Zone Infrastructure Development project. The audit objectives were to determine whether the project was achieving its planned results, and to selectively evaluate internal controls and compliance with applicable laws and regulations.

The results of the project will be less than expected. The road construction component, area development studies component, and land purchase and titling component were less successful than planned; while on the other hand, the community development component was producing very good results.

Three serious internal control weaknesses were found. First, the results of the project coordination and area development studies component and the results of the land purchase activity suggested that USAID/Costa Rica did not supervise these activities closely enough. Also, it was evident that the goals for the land purchase and titling component were established arbitrarily, without sufficient participation of the implementing agency in the project design. Finally, the original implementation schedule for the road construction component was overly optimistic, leading to unanticipated increases in the cost of the component and a reduction in the number of kilometers of road built.

The audit showed that the project's land purchase activity was not implemented in accordance with the relevant legal and policy guidance. Also, two studies required by the loan agreement, which could have helped mitigate the adverse environmental consequences of the project, had not been undertaken four months after the original project assistance completion date.

The Mission made many attempts to correct the problems experienced on this project, and its efforts led to the replacement of two project directors in two years. It should also be noted that while the project will not completely achieve its intended results, there were several significant accomplishments. Perhaps the principal achievement was the construction of 89 kilometers of all-weather road in a region which had been almost inaccessible during the rain season.

The first report finding is that three of the project's four components were less successful than planned. The second finding is that additional actions were required to mitigate the project's adverse environmental effects.

The road construction component, area development studies component, and land purchase and titling component were significantly less successful than planned in the project agreement. On the other hand, the community development component will likely exceed its goal of 65 community development projects. The most important factors which prevented the project from completely achieving its objectives were: limited managerial capability in the implementing institutions, an unrealistic implementation schedule, inaccurate cost estimates, a lack of interest in implementing the project on the part of some project staff, a lack of detailed planning for the land purchase and titling component, and weak management of the area development studies component. As a result, the project will only partially achieve its purpose of providing a basis for the efficient and equitable development of the project area, as measured by the objectively verifiable indicators in the project paper. The report recommends that USAID/Costa Rica: ensure that the Government of Costa Rica maintains the roads built under this project, deobligate or reprogram excess funds from one project component, and ensure that families receiving land under this project have signed agreements specifying their rights and obligations vis-a-vis the implementing agency. USAID/Costa Rica agreed with the intent of the recommendation but disagreed with some of the finding's conclusions.

The Foreign Assistance Act and policies adopted by AID emphasize the need to protect humid tropical forests and endangered and threatened species. By providing easier access into and within the project area, the Northern Zone Infrastructure Development project introduced the possibility and indeed the probability of environmental degradation of a remote region of Costa Rica. Not enough had been done to prevent deforestation, or to protect or even to identify endangered and threatened species in the project area. Planned studies which were expected to lead to the establishment or expansion of biological reserves, forest reserves, and protection zones had not been started because neither the responsible project staff nor USAID/Costa Rica placed sufficient priority on the studies. In addition to the indirect environmental effects of the project, the project's land purchase and titling component had actively contributed to deforestation by converting forested land to agricultural uses. The conversion of these lands was accomplished without meeting certain preconditions imposed by the Foreign Assistance Act and AID policy. Neither USAID/Costa Rica nor the implementing agency for the land purchase and titling component had developed criteria establishing when and under what circumstances it might be acceptable to clear forests to permit colonization. If nothing further is done to minimize the adverse environmental effects of this project, the project's benefits may be partially or completely offset by the loss of valuable forests and the habitats of endangered and threatened species. The report recommends that USAID/Costa Rica obtain a commitment from the Government of Costa Rica to finish planned ecological studies with its own funds after the project ends, and that the Mission not approve any further land purchases until the implementing agency adopts procedures which protect forested

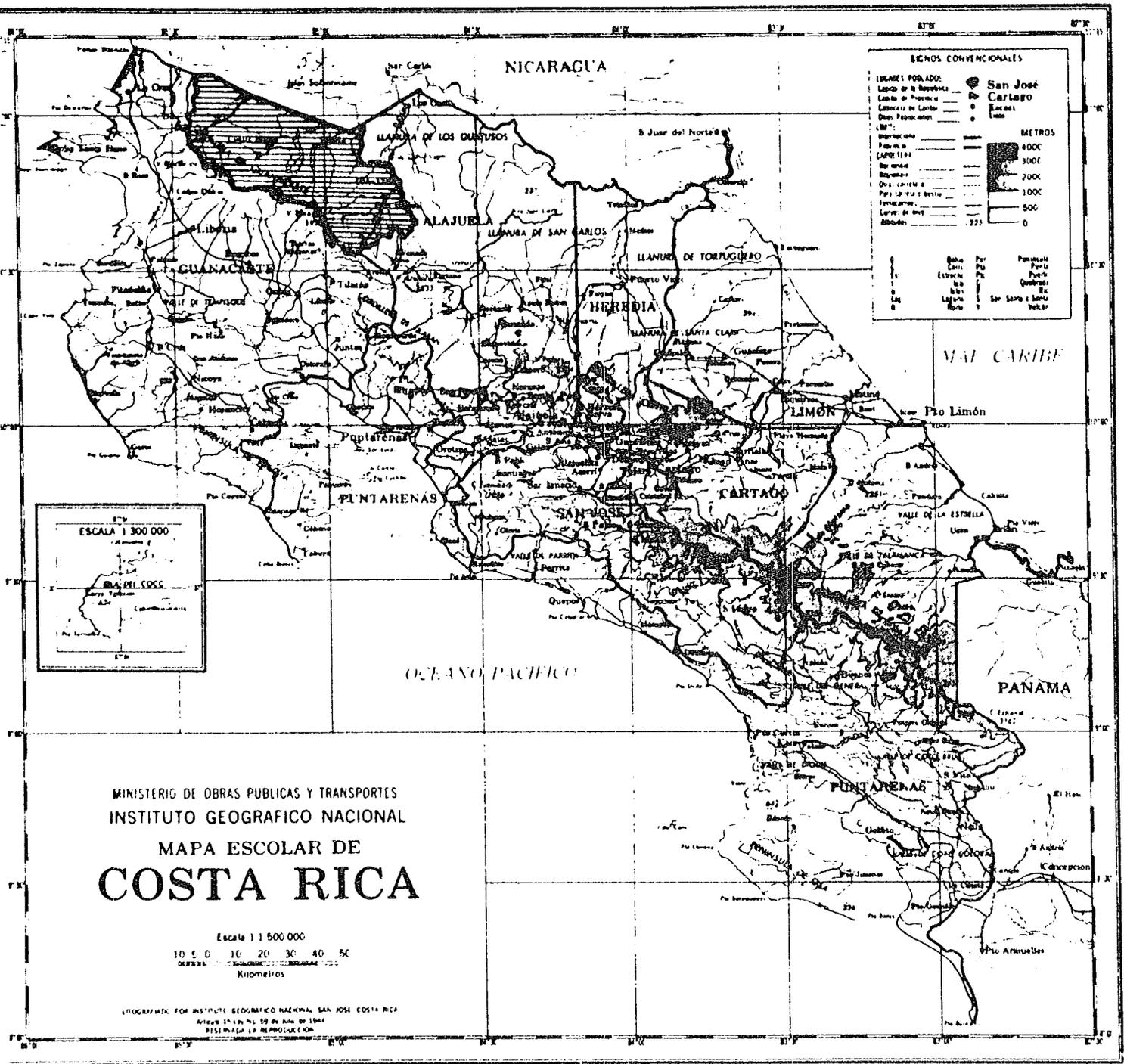
lands. USAID/Costa Rica suggested minor changes to this finding but agreed with the recommendation.

The Mission asked that the following summary of its response to the draft audit report be inserted in this Executive Summary:

USAID/Costa Rica does not agree with the finding that the road construction component was significantly less successful than planned. The road that was actually constructed did not follow the identical trajectory as the road discussed in the project paper but was shorter, less meandering, and constructed using improved standards in order to become an effective link in the road system between the Atlantic and Pacific regions of Costa Rica. Because of the change in the trajectory, the number of residents with access to all-weather roads was increased from the planned 35,000 residents to 38,000 residents. The USAID considers this a successful mid-course correction of a project design which controlled cost and increased the number of beneficiaries.

Further, we do not believe that completion of the repayment agreements by the settlers should be a pre-condition to future financing of the planned Northern Zone Consolidation Project. Under a local currency project signed with the Agrarian Development Institute (IDA), 1,000 titles are to be furnished to settlers in the Northern Zone. The provision of titles will require that the settlers sign a repayment agreement with IDA. USAID is committed to having IDA include in their agreements with settlers not only clauses covering payment terms but also future services that settlers under the land purchase and titling component may expect. In our opinion, developing a viable, effective plan to having the repayment agreements signed and monitoring the plan's implementation is more practical and relevant than either option offered in the draft audit report. USAID does not agree with conditioning the future financing of the proposed Northern Zone Consolidation Project to obtaining evidence that the agreements have been signed. Further, USAID does not agree with closing the recommendation, as suggested [in] the draft audit report, based on notification to the Government of Costa Rica that the agreements must be signed before the new project is signed. The first option could lead to a delay in signing the follow-on project (which contains a significant environmental component) and the second could leave the Mission in the position of having the recommendation closed but not complied with at the time of signing the proposed project. Moreover, fully signing all repayment agreements, while desirable, is not related to the effective implementation of the proposed new project and we see no logic in the artificial linkage that the audit report is making. We request that the recommendation be revised to eliminate all pre-conditioning on future financing.

Office of the Inspector General



The project area is indicated by shading in the upper left-hand corner.

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NORTHERN ZONE INFRASTRUCTURE
DEVELOPMENT PROJECT (NO. 515-0191)

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PART I - INTRODUCTION

A. Background

The Northern Zone project area, located in northwestern Costa Rica near the border with Nicaragua, covered 1,023 square miles and had a population of about 35,000 people in 1983. The inhabitants' average income and standard of living in terms of health, education, and housing were among the lowest in Costa Rica. The major development constraint in the area was a lack of adequate all-weather roads. Land suitable for intensive annual and perennial crop production was being used primarily for beef production, at least partly because cattle could walk to market while fruits and vegetables had to be transported. By improving access into and within the project area, it was thought that the area could support a larger population dedicated to more intensive agriculture. In addition, the Government of Costa Rica placed a high priority on integrating the project area into the national economy because of continuing difficulties and border incidents with Nicaragua.

The purpose of the Northern Zone Infrastructure Development project (No. 515-0191) was to provide a basis for the efficient and equitable development of the project area by (1) improving access to markets, services, and land; (2) expanding community-level infrastructure; and (3) expanding the knowledge base required to plan and initiate productive investments. The project included four components. By far the largest was the road construction component, which was to finance 152 kilometers of all-weather gravel roads. The community development component was planned to finance 65 village-level infrastructure projects such as schools, community centers, and small bridges. The project coordination and area development studies component was to finance the cost of establishing and operating the project office in Upala, as well as an unspecified number of feasibility studies and pilot projects. The land purchase and titling component, financed entirely with PL 480 Title I counterpart funds, was to finance the purchase of 15,000 hectares of land for eventual colonization, as well as the provision of titles to 1,000 small- and medium-sized farmers in the project area.

The Ministry of National Planning and Economic Policy was in charge of coordinating the project, and also operated the pre-investment fund which was used to fund feasibility studies and pilot projects. The Ministry of Public Works and Transport managed the road construction component, and the National Community Development Organization implemented the community development component. Finally, the Agrarian Development Institute was in charge of the land purchase and titling component.

The project agreements were signed on July 29, 1983, and the project assistance completion date had been extended one year to April 30, 1988. The \$20.8 million project budget included \$14.7 million in AID loan and grant funds and the equivalent of \$6.1 million in cash and in-kind

counterpart contributions. 1/ As of July 31, 1987, a total of \$16.2 million had been disbursed. Additional information on the project's financial status is presented in Exhibit 1.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa performed a program results audit of USAID/Costa Rica's Northern Zone Infrastructure Development project. The audit objectives were to determine whether the project was achieving its planned results, and to selectively evaluate internal controls and compliance with applicable laws and regulations.

To accomplish these objectives, documentation such as agreements, reports, accounting records, and correspondence was reviewed. Interviews were conducted with officials in USAID/Costa Rica, the Ministry of National Planning and Economic Policy, the Ministry of Public Works and Transport, the National Community Development Organization, the Agrarian Development Institute, the Ministry of Agriculture and Animal Husbandry, the Central Bank, and the National Bank of Costa Rica. Project beneficiaries were also interviewed, and activities in the project area were observed. The project had not been audited previously.

The project internal controls implemented by the Ministry of National Planning and Economic Policy, the National Community Development Organization, and the Agrarian Development Institute were selectively reviewed as discussed in the Internal Control section of this report. This examination covered controls over both AID funds and counterpart contributions. The audit also included reviews of compliance with certain sections of the Foreign Assistance Act of 1961, as amended, AID's Policy and Program Guidance on Humid Tropical Forests, and the provisions of the loan and grant agreements.

The audit covered activities from July 1983 to September 1987, including \$11.9 million in AID disbursements. The audit was performed from June to September 1987, and was made in accordance with generally accepted government auditing standards.

1/ Throughout this report, Economic Support Fund and PL 480 Title I local currency is converted to dollars at the exchange rate used to "generate" the local currency.

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PART II - RESULTS OF AUDIT

The results of the project will be less than expected. The road construction component, area development studies component, and land purchase and titling component were less successful than planned; while on the other hand, the community development component was producing very good results.

Three serious internal control weaknesses were found. First, the results of the project coordination and area development studies component and the results of the land purchase activity suggested that USAID/Costa Rica did not supervise these activities closely enough. Also, it was evident that the goals for the land purchase and titling component were established arbitrarily, without sufficient participation of the implementing agency in the project design. Finally, the original implementation schedule for the road construction component was overly optimistic, leading to unanticipated increases in the cost of the component and a reduction in the number of kilometers of road built.

The audit showed that the project's land purchase activity was not implemented in accordance with the relevant legal and AID policy guidance. Also, two studies required by the loan agreement, which could have helped mitigate the adverse environmental impact of the project, had not yet been undertaken.

The Mission made many attempts to correct the problems experienced on this project, and its efforts led to the replacement of two project directors in two years. It should also be noted that the project accomplished the construction of 89 kilometers of all-weather road in a previously isolated region, the completion of 52 community development projects with 30 more underway, the creation of 31 new development committees, and the creation of 21 new development associations.

The first report finding is that three of the project's four components were less successful than planned. The second finding is that additional actions were needed to mitigate the project's adverse environmental effects.

The first recommendation is that USAID/Costa Rica: ensure that the Government of Costa Rica maintains the roads built under this project, deobligate or reprogram excess funds from one project component, and ensure that families receiving land under the project sign agreements specifying their rights and obligations vis-a-vis the implementing agency. The second recommendation is that USAID/Costa Rica obtain a commitment from the Government of Costa Rica to finish planned ecological studies with its own funds after the project ends, and that the Mission not approve any further land purchases until the implementing agency adopts procedures to protect forested lands.

A. Audit Findings and Recommendations

1. The Project's Achievements Were Less than Expected

The road construction component, area development studies component, and land purchase and titling component were significantly less successful than planned in the project agreement. On the other hand, the community development component will likely exceed its goal of 65 community development projects. The most important factors which prevented the project from completely achieving its objectives were: limited managerial capability in the implementing institutions, an unrealistic implementation schedule, inaccurate cost estimates, a lack of interest in implementing the project on the part of some project staff, a lack of detailed planning for the land purchase and titling component, and weak management of the area development studies component. As a result, the project will only partially achieve its purpose of providing a basis for the efficient and equitable development of the project area, as measured by the objectively verifiable indicators in the project paper.

Recommendation No. 1

We recommend that USAID/Costa Rica:

- a. obtain evidence that the Government of Costa Rica has made arrangements for maintaining the roads built under this project,
- b. deobligate or reprogram as required \$82,000 from the project coordination and area development studies component, and
- c. obtain evidence that the Agrarian Development Institute has a viable plan for signing agreements with settlers specifying loan repayment terms and what further services settlers under the land purchase and titling component may expect from the Institute, before financing the planned Northern Zone Consolidation project.

Discussion

The road construction, area development studies, and land purchase and titling components were less successful than planned, while the community development component will likely exceed expectations. Each project component is discussed in the sections that follow.

Road Construction - Originally, 152 kilometers of all-weather roads was to be built under this component. This goal was later revised downward to 89 kilometers. The final design for the main truck road was 17 kilometers shorter than planned, and no funds were left over to build 45 kilometers of planned feeder roads even though the component budget was increased from \$13.4 million to \$14.3 million. Cost increases under this component occurred for at least two reasons.

First, the implementation schedule developed during the project design underestimated by up to 15 months the length of time required to award the architectural/engineering (supervision) and construction contracts.

The original schedule assumed that the supervision contract could be signed by January 1984, but the contract was not actually signed until December 1984. The construction contract was planned to be signed by August 1984, but was not actually awarded until December 1985. As a result of these unanticipated contracting delays, the road was not likely to be completed until at least September 1987, rather than in December 1986 as originally planned. These procurement delays led to cost increases due to the effects of inflation (which was growing at an annual rate of about 10 percent).

A second reason for cost escalation which led to reduced goals for the road component was the redesign of the main trunk road. The study done during the project design estimated that earth movement totaling 467,515 cubic meters would be required. According to Mission officials, the final road design called for movement of 1.4 million cubic meters of earth, or an increase of about 200 percent.

While much less road than was planned will be built, a more serious problem at the time of our audit was the lack of provision for maintaining the new roads built under the project.

The road maintenance issue was first raised during AID/Washington's review of the project identification document. The Development Assistance Executive Committee advised the Mission that the project paper should:

. . . include an analysis of the maintenance requirements for roads in the project area. The analysis should discuss the institutional capacity of organizations involved in maintaining the roads which should include an assessment of the amount of available resources, manpower, and machinery.

The project paper stated that the Ministry of Public Works and Transport (MOPT) had a backlog of road maintenance work. It pointed out that the Ministry was receiving technical assistance directed toward installing modern administrative systems and preparing a maintenance program. The project paper anticipated that this technical assistance would improve the Ministry's road maintenance capability. In its review of the project paper, AID/Washington raised the road maintenance issue a second time, questioning whether the Mission had a firm commitment from the Government of Costa Rica to provide the resources needed to maintain the roads, and questioning whether a covenant to this effect should be included in the loan agreement. No such covenant was in fact included in the agreement.

In September 1987, the roads were almost completed, but the MOPT had made no arrangements to maintain them. According to the company which designed the roads and the MOPT engineer in charge of the roads component, the road design was unique in Costa Rica in that the surface material consisted of a homogeneous mixture of fine gravel and earth. Maintaining the roads would require training as well as dedicated equipment and personnel. The MOPT had set aside no funds for this purpose, although presumably either PL 480 Title I or Economic Support Fund local currency could be made available if necessary.

The Project Advisor explained that it would have been difficult to engage the MOPT in a dialogue on road maintenance until the roads themselves were in existence. He was also concerned that a "quick fix" solution, such as programming AID-controlled local currency for road maintenance, could impede efforts to develop a more sustainable maintenance solution. The Advisor was hopeful that a system could be devised for maintaining the roads with revenues raised in the project area. In our opinion, this would be the most desirable arrangement. If a long-term solution cannot be developed soon, however, interim measures will have to be taken. Without maintenance, the roads will experience significant deterioration in only a few months.

Project Coordination and Area Development Studies - This component was to finance the operating costs of the project coordination office, as well as an unspecified number of feasibility studies and pilot projects.

The project coordination office did not function satisfactorily. During most of the project, key staff in the coordination office were seemingly more interested in political infighting than in implementing the project. According to the Project Advisor, there was no real analysis of the factors affecting the progress of each project component, no collective establishment of goals, and little communication between the staffs of the agencies which were implementing the project. Inadequate administration of the office was evidenced by inappropriate use of project vehicles, a lack of control over telephone use, late salary payments, and unpaid bills. It was hoped that a new project director who arrived in June 1987 would improve the effectiveness of the coordination office.

The feasibility study and pilot project activity had progressed very slowly. Project staff attributed the poor performance of this activity to a lack of coordination between the two offices in the Ministry of National Planning and Economic Policy (MIDEPLAN) which were responsible for designing and approving the studies. It was also evident to us, judging from the minimal results achieved, that USAID/Costa Rica had not done enough to try to accelerate implementation of this activity. It is true that the Mission repeatedly informed the Government of its concern over the lack of progress under this activity, and without the Mission's efforts additional delays probably would have occurred. However, we believe that at some point the Mission should have taken some additional steps. For example, two studies recommended by the project environmental analysis and required by the loan agreement had still not been undertaken when our audit was completed in September 1987, four months after the original project assistance completion date. The Mission must bear some responsibility for this unacceptable delay. In our opinion, USAID/Costa Rica should have suspended disbursements under this component or taken stronger action if necessary to get these studies underway.

Four feasibility studies had been started. Two studies (performed by the same group of consultants) were to provide advice on establishing two agricultural input stores in Upala and San Rafael de Guatuso. The consultants did a poor job and the studies were suspended after \$15,608 had been spent. According to the head of MIDEPLAN's pre-investment

office, the consultants were selected because of their close personal ties with the former project director. A third study was supposed to provide practical guidance on pursuing agricultural, livestock, and agroforestry activities in the project area. In fact, the study lacked practical recommendations, although the project director indicated that it did provide useful reference information on the agricultural potential of the area. The fourth study successfully demonstrated the feasibility of a furniture factory in Buena Vista. The French Government had donated equipment for this purpose, and the factory was about to begin operations.

Four pilot projects had been approved, to conduct trials of black pepper, cocoa, vanilla, and ginger in the project area. The field activities on two of these projects began in June 1987.

Because of the slow progress in this activity, only \$167,667 in AID funds were needed to pay for the studies and pilot projects already approved, including the two studies recommended by the project environmental assessment. Therefore, \$82,333 was available for deobligation or reprogramming from this component (see Exhibit 2). In its comments on the draft report, USAID/Costa Rica stated that of the \$167,667 in AID funds disbursed or committed, over half had been committed within the last six months. It noted that the project coordinating office was developing four new projects with an estimated AID contribution of \$77,500, and stated that it would be unwise to deobligate or reprogram \$82,333 from a component which had begun to show significant signs of recuperation. While there is no need to deobligate or reprogram funds if they can be wisely spent on development studies, we question whether now, four months before the project assistance completion date, is an appropriate time to be designing new activities. We urge the Mission to consider whether some of these monies might not be better spent elsewhere. Also, we would discourage funding any studies which cannot be completed by the April 30, 1988 project assistance completion date.

Land Purchase and Titling - According to the loan agreement, this component was to finance the purchase of 15,000 hectares of land for eventual colonization, as well as the provision of 1,000 titles to farmers owning less than 100 hectares of land. The titling activity specifically excluded owners of land adjudicated by the Agrarian Development Institute (IDA). As of July 1987, 4,292 hectares of land had been purchased and 117 land titles had been issued.

During project implementation, the land purchase activity was expanded to include the parcellation and distribution of land to IDA settlers. (These additional activities were planned in the project paper, but not included in the loan agreement.) According to IDA's project director, it made no sense to state the goal of this activity in terms of a quantity of land (i.e. 15,000 hectares) because this did not take into account the quality of land purchased. He said that IDA's current goal was to purchase enough land of sufficient quality to settle between 700 and 800 families. As of March 1987, 415 families had been settled, and it appeared that sufficient money and time were available to settle about 700 or 800 families by the project assistance completion date.

The families settled through this activity received payments to permit them to build their homes, as well as subsistence payments intended to support them during the first six months of their residence. In accordance with IDA's policy of recovering its costs, these payments, as well as the price of the land, were considered loans which the settlers would have to repay. The expected terms were that the loans would earn interest at 8 percent and be paid back over 20 years, after a five-year grace period during which interest would accrue.

Even at a subsidized interest rate of 8 percent, we doubt that the settlers will be able to pay back the full cost of the land, the housing subsidy, and the subsistence payments. We estimate that after the five-year grace period, the average settler will owe IDA about \$5,150. Using an annual interest rate of 8 percent, the settlers would have to make annual payments of more than \$500 a year to retire the debt in 20 years. A 1982 survey in the project area found that the average income of small farmers using mostly family labor was only about \$800 a year. We doubt that families at this income level will be able to devote 60 percent of their income to retiring debt.

None of the settlers had signed a repayment agreement with IDA, and none of them knew how much they were expected to pay. This issue was raised in a July 1986 report by the Project Advisor which described how the absence of formal agreements could encourage dependency. The report stated that:

The major [deterents] to Northern Zone economic growth and socio-political stability are the lack of definition and delimitation of IDA functions, titling of IDA settlers and the integration of IDA beneficiaries into the national social, economic and political systems.

The project advisor noted that the selection process for IDA beneficiaries had been heavily influenced by political pressure groups; a factor which favored the selection of beneficiaries who would look to the government to solve their problems. He went on to point out that:

Beneficiaries of IDA who are currently being settled have no contract arrangement with IDA to establish when or how much they will pay for their land, what [IDA's] obligations are, or when titles will be available By not placing limitations on IDA's activities in either time or function, the identity of settlers as IDA beneficiaries and their dependency on IDA are perpetuated. Integration with traditional farmers is not only impeded; it is made virtually impossible.

The lack of title to the individual farm units makes the beneficiary dependent on IDA for credit through the "Caja Agraria" or dependent on IDA to provide the guarantee for a bank loan.

IDA needed to determine what portion of its costs it could reasonably expect to recover from families settled under the purchase activity, and sign repayment agreements with the families. It should also sign agreements specifying the rights and obligations of both IDA and its beneficiaries, and specifying when the beneficiaries will receive title to their land. Completion of these agreements should be made a precondition to financing the planned Northern Zone Consolidation project. During the remainder of the Northern Zone Infrastructure project, it would be very desirable for IDA to enter into formal agreements with beneficiaries before the beneficiaries receive land under the project. In this way, families will know their rights and obligations before they decide to participate in the project.

The titling activity got off to a slow start. Due to a lack of detailed design work, it was assumed that there were large, concentrated groups of eligible farmers who lacked land titles. In fact, the potential beneficiaries were somewhat dispersed throughout the project area. Through a survey and radio advertisements, IDA was eventually able to identify five areas to work in. A dispute over the rate to be paid to contracted topographers also impeded progress in this activity. As a result of this rate dispute, IDA did not contract the first of six topographers until August 1986. A third problem was that resources for this activity were diverted to other activities. Some of the topographers were detailed to the land purchase activity to measure parcels for IDA settlers, and two vehicles purchased for titling work were used by the President and Manager of IDA. Mission staff later had the vehicles returned to the project. We were told that a delay in revalidation of titling legislation by the Costa Rican Congress also held up this activity. As a result of these problems, the Chief of IDA's Titling Department estimated that slightly less than 800 titles could be issued by the project assistance date, rather than the 1,000 titles planned.

Community Development - This component was to finance 65 small infrastructure projects such as schools, community centers, and bridges. As of July 1987, 47 projects were completed and 26 were underway. Because the beneficiaries contributed some materials and unskilled labor, successful completion of the projects reinforced social cohesion and encouraged the beneficiaries to undertake other projects to benefit their communities.

Impact of Implementation Problems - Because of the problems experienced on three of the four project components, the project will only partially achieve its purpose of establishing a basis for efficient and equitable development in the project area, as measured by the objectively verifiable indicators established in the project paper.

The first indicator was that 35,000 area residents (the estimated population of the project area) would have all-weather access to markets and services. Since 45 kilometers of planned roads will not be built with project funds, we concluded that fewer residents would have all-weather access. According to USAID/Costa Rica, however, a study conducted in anticipation of a follow-on project found that 38,000 people

will have access. We find it difficult to believe that the 89 kilometers of road actually built will reach more people than the 152 kilometers of road originally planned. Since we were not provided a copy of the study, however, we have no means of evaluating the Mission's figure.

The second indicator was that an estimated 20,000 people would benefit directly from 65 community development projects. More projects than planned will probably be completed, but as of July 1987 only 6,640 people were benefiting directly from the 74 projects underway or completed.

The third indicator established in the project paper was "feasibility studies completed and new agriculturally related investments started." Little had been accomplished in the area development studies component. To the best of our knowledge, the only new investment started as a result of the studies and pilot projects activity was the furniture factory in Buena Vista which was about to begin operations.

The fourth indicator was that an estimated 700 to 800 landless families would become landowners. At least close to this number of families will probably be settled by the project assistance completion date. However, the way IDA chose to implement the land purchase activity has probably done more to encourage dependence than to help the settlers make a positive contribution to development in the project area.

The fifth and final indicator was that an estimated 1,000 farmers would receive title to their land. The Chief of IDA's Titling Department estimated that slightly less than 800 titles could be issued by the end of the project.

While the project will not fully achieve its purpose as measured by the objective criteria established in the project paper, some observers have concluded that the project would achieve its purpose, citing subjective evidence. For example, the author of a February 1987 evaluation (who had visited the project area during the project design) concluded that "the project is well on the road to achieving its stated purpose." He stated that since he first visited the area there had been visible change in physical infrastructure and in the organization and activity of local groups. He further stated that:

There also seems to be a sense of optimism about the future on the part of the inhabitants of the area with whom I conversed. The very fact that there is a considerable level of complaint about the slowness of certain government actions, can be taken as evidence of the energizing impact of the project on the mentality of the population and its leaders.

USAID/Costa Rica cited other signs of development in the project area, such as the number of families with access to all-weather roads, potable water, and electricity; new businesses established in Upala and San Rafael; new agricultural practices; and new agribusiness investments.

In conclusion, fewer roads were built at a higher cost than planned, but the road construction component did achieve the construction of 89 kilometers of all-weather gravel road in a region of Costa Rica which had

been virtually inaccessible during the rainy season. Arrangements for maintaining the roads needed to be made quickly, to prevent deterioration of the roads after their expected completion in September 1987. The performance of the project coordination and area development studies component was unsatisfactory, and \$82,000 was available for deobligation or reobligation from this component. The land purchase and titling component had not achieved its objectives, but part of the shortfall was due to the arbitrary nature of the goals set for these activities. The Agrarian Development Institute needed to establish a formal, contractual relationship with the beneficiaries settled under this component, so that the settlers would fully understand their rights and obligations. While we are not making a formal recommendation, USAID/Costa Rica should secure the active participation of the Government of Costa Rica in the design of the Northern Zone Consolidation project to avoid mistaken assumptions such as those which underlay the land purchase and titling component. The project's success story, the community development component, will likely surpass its goal of building 65 small infrastructure projects. USAID/Costa Rica was considering financing a similar activity, which would emphasize potable water projects, under the planned Northern Zone Consolidation project.

Management Comments

USAID/Costa Rica agreed with most of the facts presented in the finding and agreed with the intent of the recommendation. It suggested that parts of the recommendation be reworded, however, and disagreed with some of our conclusions.

Most importantly, the Mission did not agree that the road component was less successful than planned. It stated that reductions in the kilometers of road built and increases in the cost of this component resulted in an increase in the number of residents with access to all-weather roads.

The Mission also disagreed with our conclusion that it had not supervised the area development studies and land purchase activities closely enough. It stated that:

Apparently, the RIG's position is that, irrespective of the efforts undertaken by the Project Officer in monitoring and overseeing project implementation; unless the results of such progress are uniform progress across the board, then the supervision and monitoring are not sufficient.

The Mission also rejected our suggestion that it should have suspended disbursements under the area development studies component to provide an incentive to the Government to get the planned hydrology and flora and fauna studies underway.

Office of Inspector General Comments

We have adopted USAID/Costa Rica's proposed changes in the recommendation.

In response to the Mission's comments on the road component, it is difficult to accept that the 89 kilometers of road actually built (at a higher cost than projected for 152 kilometers) will reach more residents than the 152 kilometers of road originally planned. In its comments, the Mission stated that 38,000 residents had all-weather access, rather than 35,000 residents planned. It is important to remember that the original figure was an estimate of the population of the entire project area. While we were not furnished a copy of the study cited by the Mission to support the higher figure, we suspect that the discrepancy may be a result of the inherent difficulty in estimating how many people will benefit from a new road. Alternatively, the figure cited by the Mission may simply be a new estimate of the population of the entire project area. At any rate, we continue to believe that the roads built under this project will reach fewer residents than the much more extensive network originally planned.

We also continue to believe that the Mission's supervision of the area development studies and land purchase activities was less than satisfactory. We agree with the Mission that implementation problems on bilateral projects should preferably be dealt with in a collegial fashion. When our counterparts cannot or will not work with us to remedy problems, however, AID has no choice but to take stronger measures to correct deficiencies or, if necessary, to redirect resources where they can be better spent. In our opinion, the very slow implementation of the development studies activity and the unsound implementation of the land purchase activity represent two situations where closer monitoring and/or more active Mission management would have had a beneficial effect.

2. Further Actions Were Needed to Minimize the Project's Adverse Environmental Effects

The Foreign Assistance Act and policies adopted by AID emphasize the need to protect humid tropical forests and endangered and threatened species. By providing easier access into and within the project area, the Northern Zone Infrastructure Development project introduced the possibility and indeed the probability of environmental degradation of a remote region of Costa Rica. Not enough had been done to prevent deforestation, or to protect or even to identify endangered and threatened species in the project area. Planned studies which were expected to lead to the establishment or expansion of biological reserves, forest reserves, and protection zones had not been started because neither the responsible project staff nor USAID/Costa Rica placed sufficient priority on the studies. In addition to the indirect environmental effects of the project, the project's land purchase and titling component had actively contributed to deforestation by converting forested land to agricultural uses. The conversion of these lands was accomplished without meeting certain preconditions imposed by the Foreign Assistance Act and AID policy. Neither USAID/Costa Rica nor the implementing agency for the land purchase and titling component had developed criteria establishing when and under what circumstances it might be acceptable to clear forests to permit colonization. If nothing further is done to minimize the adverse environmental effects of this project, the project's benefits may be partially or completely offset by the loss of valuable forests and the habitats of endangered and threatened species.

Recommendation No. 2

We recommend that USAID/Costa Rica:

- a. obtain a commitment from the Government of Costa Rica to fund the planned hydrologic and flora and fauna studies with its own resources after the project assistance completion date and take appropriate actions based on the results of these studies, before funding the planned Northern Zone Consolidation project; and
- b. obtain evidence that the Agrarian Development Institute has adopted land purchasing procedures which protect forested lands, before approving any further land purchases under the Northern Zone Infrastructure Development project.

Discussion

The Northern Zone Infrastructure Development project area was originally covered by humid tropical forests. Before the project began, the area was extremely isolated. Notwithstanding its isolation, a large portion of the area had been deforested, and the largest remaining forests were on the slopes of the Guanacaste mountain range. In the lower lying areas, most of the remaining forests consisted of relatively small patches covering less than four square miles each. Although the region was poorly surveyed biologically, a substantial number of endangered and threatened plants and animals were thought to be found there.

Section 118(c) of the Foreign Assistance Act of 1961, as amended provides that:

In providing assistance to developing countries, the President shall do the following: . . . Place a high priority on conservation and sustainable management of tropical forests. . . . support projects and activities . . . which help developing countries identify and implement alternatives to colonizing forested areas . . . support projects and activities to conserve forested watersheds and rehabilitate those which have been deforested . . . Require that any program or project under this chapter significantly affecting tropical forests . . . be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and take full account of the environmental impacts of the proposed activities on biological diversity.

Another paragraph of Section 118(c) prohibits the use of development assistance funds to colonize forest lands unless:

. . . an environmental assessment indicates that the proposed activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development . . .

While this prohibition did not apply to the counterpart funds used to fund the land purchase and titling component, in our opinion project counterpart funds should not be used for environmentally unsound activities which AID is prohibited from supporting.

The concerns expressed in the Foreign Assistance Act are the same as those reflected in AID's Policy and Program Guidance on Humid Tropical Forests. This guidance states that:

In the case of humid tropical forests . . . there is a special need to recognize that the most valuable products of these forests may not as yet be fully identified, [may be] unique to humid tropical ecosystems and essential to the survival of other ecosystems, or have a value which is not now nor will be in the immediate future accurately reflected in the market.

Given that the world's scientific community is just beginning to understand the importance of humid tropic forests, it is AID's general policy to exercise extreme caution in pursuing development

projects which lead to the full or partial conversion of these forests. The development of programs affecting these types of forests should be approached from the perspective that a top priority is conservation and sustainable management of these unique resources.

AID recognizes that in the near term, the pressures of increasing population and development investments will continue to result in the conversion of humid tropical forests to other uses. However, AID's participation in activities which produce this result must follow from a careful analysis of the best sustainable use of the land and the impact of the activity on biological diversity.

By providing easier access into a previously isolated area, the Northern Zone Infrastructure project introduced a strong likelihood of environmental degradation unless steps were taken to prevent this consequence. A wildlife refuge had been established on the Eastern border of the project area, as required by a covenant in the loan agreement. Still, more needed to be done to prevent deforestation and to identify and protect threatened and endangered species in the project area.

The project environmental analysis recommended that a flora and fauna study and a study of the hydrological potential of the Eastern slopes of the Guanacaste mountain range be conducted. The environmental analysis recommended that the flora and fauna study be conducted over a period of at least one year and preferably over a two-year period. It was expected that the results of these studies would lead to the creation or expansion of biological reserves, forest reserves, or protection zones in the project area. By August 1987, when only eight months remained before the project assistance completion date, neither study had been undertaken. There was not enough time to finish the flora and fauna study, and it would be very difficult to finish the hydrologic study, before the project assistance completion date. The project staff responsible for contracting these studies did not place sufficient importance on their accomplishment. USAID/Costa Rica made many attempts to get these studies approved, but these attempts were not successful. In our opinion, the Mission should have suspended disbursements or taken stronger action if necessary to get the studies underway. Therefore, the Mission had to accept some responsibility for the unacceptable delay in beginning these studies.

In addition to the project's indirect environmental effects, the land purchase and titling component of the project contributed directly to deforestation by converting primary and secondary forest to agricultural uses. By September 1987, 4,291 hectares of land had been purchased with project counterpart funds to be parcelled and sold to settlers. Of this amount, 18 percent was covered with primary forest, 8 percent with secondary forest or brush, and 14 percent with forest which was not specifically described in the studies performed by the Agrarian

Development Institute (IDA) prior to each purchase. In all, 40 percent of the land purchased was covered with some type of forest while the remaining 60 percent was being used as pasture. (According to an estimate prepared by IDA in September 1987, only 36 percent of the land purchased was covered by forest.)

Some properties purchased had a much higher than average percentage of forest cover. For example, 73 percent of the "El Valle" property was covered by primary forest before it was purchased and settled. When we visited this settlement in July 1987, it appeared to be almost completely deforested. "Rio Celeste" was 68 percent covered by a combination of primary and secondary forest. "El Recreo" was 90 percent covered by a combination of primary and secondary forest. This property had been heavily deforested by July 1987 (see page 1 of Exhibit 3).

Significant deforestation had also occurred on properties which had less than the average amount of forest cover before they were purchased by IDA. Before it was purchased, "El Salto" was 21 percent covered by primary forest. We met with one settler on this property who said that his parcel was completely covered by forest when he arrived to take possession. By July 1987, he had completely deforested the parcel, except for one small patch of virgin forest he had decided to preserve for future enjoyment (see page 2 of Exhibit 3).

The conversion of forested lands to agricultural use through the land purchase and titling component did not comply with the relevant guidance in at least two respects. First, no consideration was given to the effect of this conversion on biological diversity, as required by the Foreign Assistance Act and AID policy. There was no way to assess this effect since the project area was poorly surveyed biologically, and the planned flora and fauna study had not been undertaken. Second, USAID/Costa Rica did not pursue the land purchase activity in the cautious, deliberate manner required by AID's Policy and Program Guidance on Humid Tropical Forests. This was evidenced by the fact that the project environmental assessment did not cover this activity. The consultant who prepared the environmental analysis told us that he was not asked to evaluate the land purchase activity, and that he was not aware that this activity was being contemplated.

IDA chose to convert forested lands to agricultural use, with USAID/Costa Rica's concurrence, for several reasons. First, IDA had no procedures or criteria specifying under what circumstances it might be acceptable to convert forest lands to farm lands, and the Mission had not required the agency to develop such procedures. Also, the Mission had not adopted its own policy on how much forest cover land purchased by IDA could have. According to the Project Advisor, he verbally recommended that AID require IDA to adopt appropriate procedures before approving land purchases. However, he said, Mission staff took the position that AID should not create obstacles to the implementation of this component. Second, forested land may have been less expensive than land which was already deforested, because IDA reduced its reference price for negotiation for forested land. Third, while the Project Advisor agreed that IDA should adopt better procedures, he believed that land which was suitable

for agriculture should probably be converted to agricultural use, given the demand for farm land in Costa Rica. (Eighty-one percent of the land IDA purchased was described as being suitable for intensive agricultural use, and 18 percent was suitable for tree crops or pastures.) We find ourselves in disagreement with the Advisor on this issue since AID has adopted the position that the value of humid tropical forests may not be fully understood or reflected in market prices, and since this component was implemented without the benefit of an environmental assessment or a biological inventory.

If nothing further is done to mitigate the adverse environmental effects of this project, the project's social and economic benefits may be partially or completely offset by the loss of valuable forests and the habitats of endangered and threatened species. According to projections done by the Ministry of Economic Policy and National Planning in 1978, Costa Rica will have to import more than 1 million cubic meters of lumber a year within the next 25 years. Given that the average price of lumber in 1982 was \$500 per cubic meter, this will represent an impossible burden for the country. Forests are also needed to maintain the quality and quantity of useable water, to preserve the genetic reservoir of plant and animal life, and to minimize soil erosion and soil depletion.

USAID/Costa Rica should ensure that the Government of Costa Rica funds the planned hydrologic and flora and fauna studies with its own resources after the project assistance completion date. The flora and fauna study should be carried out over a two-year period. The Government's commitment to taking appropriate actions based on the studies' results should be made a precondition to funding the planned Northern Zone Consolidation project. The Mission should also require IDA to adopt land purchasing procedures which protect forested lands before approving further land purchases under the Northern Zone Infrastructure project.

Mission Comments

USAID/Costa Rica generally agreed with this finding and recommendation. The Mission pointed out that four foresty reserves on the southern border of the project area existed before the project began, and that a new wildlife preserve was created as a result of a covenant in the loan agreement. It also stated that studies and pilot projects directed at increasing tree crop production had been started and that an environmental assessment would be done as part of the design of the planned follow-on project. The Mission also obtained a report from IDA which estimated that 80 percent of the forested land purchased by IDA had not yet been deforested, and that 7 percent was being held as forest reserves.

The Mission disagreed with our statement that the Mission had to accept some responsibility for the unacceptable delay in beginning the hydrology and flora and fauna studies.

Office of Inspector General Comments

In response to our request for the contracts for the hydrology and flora and fauna studies, the Mission on November 30, 1987 sent us copies of agreements which specified that the contractors would be chosen at a later date. Therefore we concluded that the studies still had not begun. Had project staff placed sufficient importance on these studies, they would have been undertaken at the beginning of the project. Because they did not, the intended end result (creation or expansion of reserves and protection zones) has been delayed several years, during which significant environmental degradation to some areas probably occurred. In our opinion, these studies were sufficiently important that the Mission should have suspended disbursements or taken stronger action if necessary to get the studies approved.

B. Compliance and Internal Control

1. Compliance

The audit included reviews of compliance with certain sections of the Foreign Assistance Act of 1961, as amended, AID's Policy and Program Guidance on Humid Tropical Forests, and the provisions of the loan and grant agreements. As discussed in finding No. 2, the land purchase activity was not implemented in accordance with the relevant legal and policy guidance. Also, two studies required by the loan agreement, which could have helped mitigate the adverse environmental consequences of the project, had not begun four months after the original project assistance completion date. Other than the conditions cited above, tested items were in compliance, and nothing came to our attention which would suggest that untested items were not in compliance with applicable laws and regulations.

2. Internal Control

The audit also included a selective examination of administrative controls and accounting controls.

The review of administrative controls was limited to the problem areas discussed in finding No. 1. The results of the project coordination and area development studies component and the results of the land purchase activity suggested that USAID/Costa Rica did not supervise these activities closely enough. Also, it was evident that the goals for the land purchase and titling component were established arbitrarily, without sufficient participation of the implementing agency in the project design. Finally, the original implementation schedule for the road construction component was overly optimistic, leading to unanticipated increases in the cost of the component and a reduction in the number of kilometers of road built.

The examination of accounting controls was limited to the controls established by the Agrarian Development Institute, the Ministry of National Planning and Economic Policy's Pre-Investment Unit, and the National Community Development Organization. The accounting controls established by these entities consisted of controls over the recording of transactions and the receipt and disbursement of funds. The examination did not disclose any material weaknesses in these controls.

C. Other Pertinent Matters

Sound management practice requires that all resources provided for a project be included in the project budget. USAID/Costa Rica programmed the equivalent of \$1.3 million (this is the total of three separate programming actions) in PL 480 Title I and Economic Support Fund local currency as additional counterpart for the Northern Zone Infrastructure Development project, but did not modify the project budget accordingly. The former Project Officer stated that he preferred not to incorporate the additional planned counterpart contributions into the project budget until the amounts actually spent were known. This explanation was not valid, in our opinion, because the purpose of a budget is to permit a comparison of the estimated cost of a project with actual expenditures. As a result, the project budget did not reflect the true planned cost of the project. While we are not making a formal recommendation, USAID/Costa Rica should review its project budgeting procedures to ensure that all local currency used as counterpart for AID projects is included in the project budgets.

AUDIT OF USAID/COSTA RICA'S
NORTHERN ZONE INFRASTRUCTURE
DEVELOPMENT PROJECT (NO. 515-0191)

PART III - EXHIBITS AND APPENDICES

Project No. 515-0191 Financial Status
as of July 31, 1987

<u>Component</u>	<u>AID Budget (\$000)</u>	<u>AID Disbursements (\$000)</u>	<u>Counterpart Budget 1/ (\$000)</u>	<u>Counterpart Disbursements 1/ (\$000)</u>	<u>Total Budget (\$000)</u>	<u>Total Disbursements (\$000)</u>
Road Construction	13,400	11,066	859 <u>2/</u>	391	14,259	11,457
Community Development	550	469	304 <u>3/</u>	434 <u>4/</u>	854	903
Project Coordination and Area Development Studies	750	380	924 <u>5/</u>	839 <u>6/</u>	1,674	1,219
Land Purchase and Titling	<u>0</u>	<u>0</u>	<u>4,006</u>	<u>2,604 7/</u>	<u>4,006</u>	<u>2,604</u>
Total	<u>14,700</u> =====	<u>11,915</u> =====	<u>6,093</u> =====	<u>4,268</u> =====	<u>20,793</u> =====	<u>16,183</u> =====

Notes:

1. Economic Support Fund and PL 480 Title I local currency is converted to dollars at the exchange rate used to generate the local currency. In some cases, local currency programming decisions were made using a different exchange rate. For example, the loan agreement called for counterpart contributions equivalent to \$2,500,000. The Government programmed 176,375,000 colones from 1984 PL 480 Title I sales proceeds for this activity, implying an exchange rate of 41.50 colones to 1 dollar. In fact, the average exchange rate used to generate PL 480 Title I local currency in 1984 was 44.03 colones to 1 dollar.
2. Of this amount, \$814,038 was never incorporated into the project budget (see page 20).
3. This amount represents planned in-kind contributions from the beneficiary communities and the National Community Development Organization.
4. This is the amount of in-kind contributions provided by the beneficiary communities only as of August 31, 1987.
5. Of this amount, \$455,610 was not incorporated into the project budget (see page 20).
6. This is the amount disbursed to the Ministry of National Planning and Economic Policy by the Central Bank of Costa Rica.
7. This is the amount disbursed to the Agrarian Development Institute by the Central Bank of Costa Rica as of June 30, 1987.

Loan Financing Required for
Area Development Studies and
Pilot Projects

<u>Activity</u>	<u>Cost in Colones</u> 1/	<u>Exchange Rate</u> 2/	<u>Cost in Dollars</u>
Agrosilvipastoral study	365,119	44.50	8,205
Upala input store study	769,410	51.45	14,955
Guatuso input store study	33,628	51.45	654
Furniture factory study	49,971	51.45	971
Hydrologic study	2,409,700	62	38,866
Flora and fauna study	2,697,404	62	43,506
Cacao pilot project	2,145,000	57.20	37,500
Black pepper pilot project	587,314	58.15	10,100
Vanilla pilot project	728,000	62	11,742
Ginger pilot project	73,112	62.60	<u>1,168</u>
Total			167,667
Amount budgeted			250,000
Amount available for reprogramming			82,333

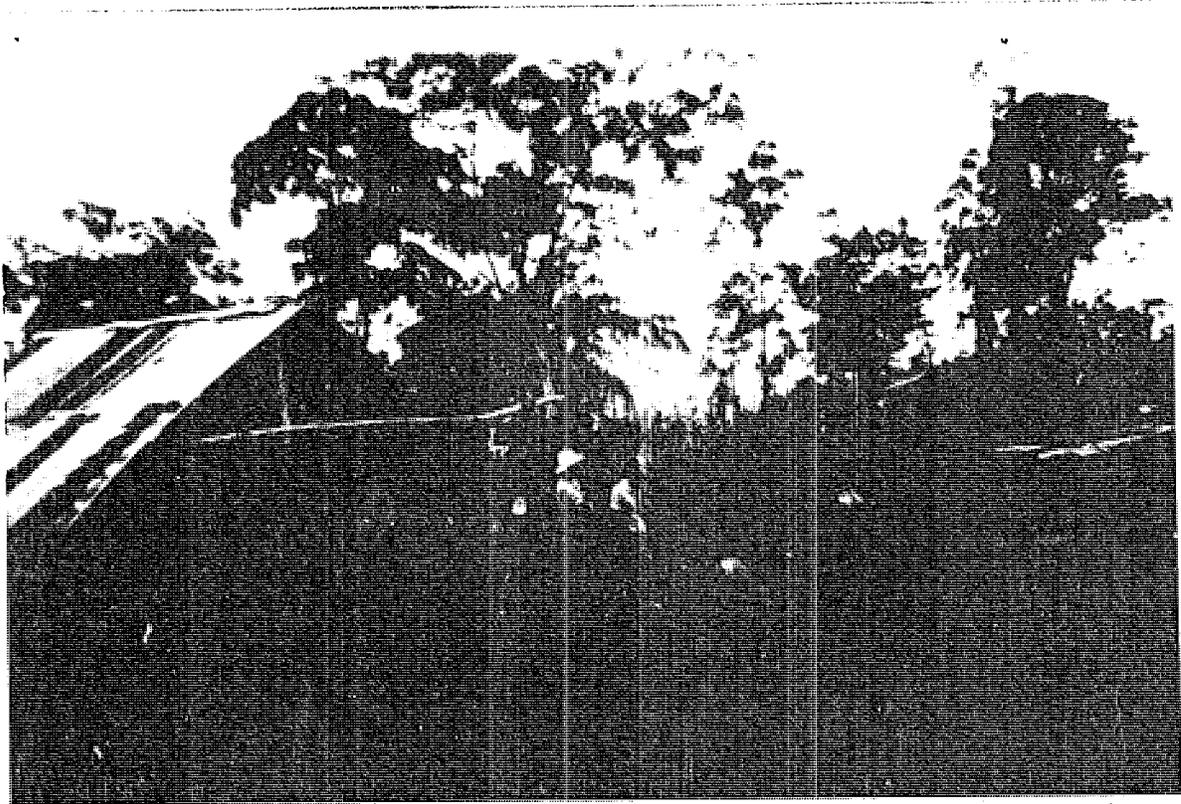
Notes: 1. This is 50 percent of the cost of each activity.

2. Colones per dollar on the date each activity was approved.

Pictures of Deforestation Occurring on Land
Purchased by the Agrarian Development Institute



"El Recreo" settlement. This picture shows the destruction of primary forest to create agricultural lands.



A parcel in "El Salto" settlement. This parcel was completely forested when the settler took possession. He had preserved a small patch of virgin forest for future enjoyment in the corner of his parcel.

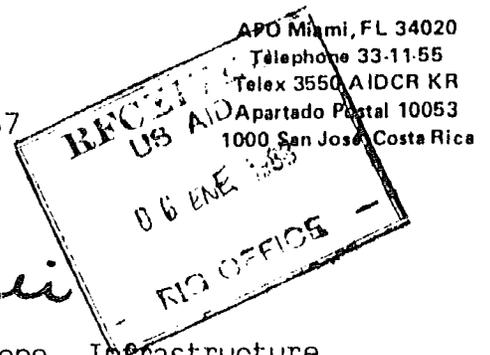


AGENCY FOR INTERNATIONAL DEVELOPMENT

UNITED STATES A.I.D. MISSION TO COSTA RICA

MEMORANDUM

December 14, 1987



TO: Mr. Coinage Gothard, RIG/A/T

FROM: Richard K. Archi, MDIR, a.i. *Archi*

SUBJECT: Audit of USAID/Costa Rica's Northern Zone Infrastructure Development Project (No. 515-0191)

USAID/Costa Rica has reviewed the subject draft report and generally agrees with most of the facts and the thrust of the recommendations presented. However, as further explained in the attached comments, we do not agree with some of the conclusions reached nor with the idea of conditioning the financing of the planned Northern Zone Consolidation follow-on project with the completion of actions recommended under this audit. Neither are we in agreement with the finding that achievements were significantly less successful than planned. Our arguments are included in the accompanying detailed comments on the draft report.

We would appreciate your inserting the following paragraphs in the Executive Summary section of the report to assure balance in the report and to convey a more accurate impression to the reader regarding the Mission's concern with implementation and capability to plan and achieve results:

"USAID/Costa Rica does not agree with the finding that the road construction component was significantly less successful than planned. The road that was actually constructed did not follow the identical trajectory as the road discussed in the project paper but was shorter, less meandering, and constructed using improved standards in order to become an effective link in the road system between the Atlantic and Pacific regions of Costa Rica. Because of the change in the trajectory, the number of residents with access to all-weather roads was increased from the planned 35,000 residents to 38,000 residents. The USAID considers this a successful mid-course correction of a project design which controlled cost and increased the number of beneficiaries.

Further, we do not believe that completion of the repayment agreements by the settlers should be a pre-condition to future financing of the planned Northern Zone Consolidation Project. Under a local currency project signed with the Agrarian Development Institute (IDA), 1,000 titles are to be furnished to settlers in the Northern Zone. The provision of titles will require that the settlers sign a repayment agreement with IDA. USAID

is committed to having IDA include in their agreements with settlers not only clauses covering payment terms but also future services that settlers under the land purchase and titling component may expect. In our opinion, developing a viable, effective plan to having the repayment agreements signed and monitoring the plan's implementation is more practical and relevant than either option offered in the draft audit report. USAID does not agree with conditioning the future financing of the proposed Northern Zone Consolidation Project to obtaining evidence that the agreements have been signed. Further, USAID does not agree with closing the recommendation, as suggested on page 23 of the draft audit report, based on notification to the Government of Costa Rica that the agreements must be signed before the new project is signed. The first option could lead to a delay in signing the follow-on project (which contains a significant environmental component) and the second could leave the Mission in the position of having the recommendation closed but not complied with at the time of signing the proposed project. Moreover, fully signing all repayment agreements, while desirable, is not related to the effective implementation of the proposed new project and we see no logic in the artificial linkage that the audit report is making. We request that the recommendation be revised to eliminate all pre-conditioning on future financing."

The detailed comments accompanying this letter follow the outline of the draft report to assist in incorporating them in the body of the report if deemed desirable or feasible.

Attachment a/s

USAID/Costa Rica's Response to RIG's Draft Audit Report on the
Northern Zone Infrastructure Development Project (No. 515-0191)

The USAID has reviewed the above mentioned draft audit report and our observations are presented in the same format as that of the auditors' draft report.

"EXECUTIVE SUMMARY" SECTION

We are requesting that the two paragraph Mission position in the transmittal memorandum be inserted in the final report in order to assure balance in the report and to convey a more accurate impression to the reader regarding the Mission's concern with implementation. Our comments on the body of the report will, if accepted, require appropriate changes in the Executive Summary Section.

PART I - INTRODUCTION

The Mission has no comments on this part of the draft audit report.

PART II - RESULTS OF AUDIT

On page 5 of the draft audit report, the conclusion is reached that USAID/CR did not supervise the project coordination and studies component nor the land purchase activity closely enough. The Mission believes such a statement to be unfounded considering that a full-time, effective advisor was resident in Upala for this purpose. The Mission's belief that this conclusion is unsupportable is strengthened by the factual comment on page -ii- of the Executive Summary that the Mission made many attempts to correct problems experienced on the project. Further, the report acknowledges on page 12 that "without the Mission's efforts, additional delays probably would have occurred." Apparently, the RIG's position is that, irrespective of the efforts undertaken by the Project Officer in monitoring and overseeing project implementation, unless the results of such oversight are uniform progress across the board, then the supervision and monitoring are not sufficient. The implied suggestion on page 13 that we could have taken our money and gone home is not a particularly useful suggestion in implementing this bilateral project. We believe our efforts to strengthen the top leadership in the implementing unit represented the correct approach which will yield the greatest results over the long run. In our opinion, the report's conclusion that the project coordination and studies component were not supervised closely enough cannot be drawn from a reasonable review of the facts.

Page 6 of the report states that two studies required by the agreement had not yet been started four months after the original project assistance completion date. Considering the difficulties that were experienced in getting an effective management team assembled in the implementing unit, slippage in some implementation dates were inevitable. The Mission was concerned about implementation of all components of the project. Because of implementation delays, the project assistance completion date was extended to April 30, 1988 and the new date was in effect at the time of the audit. The Mission suggests that the report point out that the Mission was serious about seeing these two studies completed and extended the completion date in a successful attempt to get the studies underway.

The first full paragraph of page 6 mentions that there were several significant accomplishments but names only one. The Mission believes that significant accomplishments also include: (1) the conclusion of 52 community development projects with an additional 30 projects in process, and (2) the creation of 31 development committees in the area (none were envisioned in the project paper), and (3) 21 new development associations in addition to the previously existing 31 associations (the project paper envisioned a total of only 35) covering 100% of the project area. These associations were expected to contribute 30% in counterpart but have already contributed 70%. Further, although the road component was shortened by 17 kilometers, it was redesigned in such a way as to increase the number of beneficiaries.

A. Audit Findings and Recommendations

1. The Project's Achievements Were Less than Expected

The Mission does not accept the conclusion that the road construction component of the project has been significantly less successful than planned in the project agreement. Our specific comments in this regard are detailed in the rest of this section of our response.

Various studies on file at MIDEPLAN demonstrate that "a basis for the efficient and equitable development of the project area" has been achieved. Development in the project area is evidenced by improvements in the number of families with access to all-weather roads, potable water and electricity, increase in the number of business establishment in Upala and San Rafael, the number of sustainable agricultural practices, and the number of agro-business investments, since 1984.

Recommendation No. 1

The Mission believes that Recommendation No. 1, subparts (a) and (c) are consistent with the project purpose, even though they are outside the parameters of both the project paper and the loan agreement. The Mission believes these are significant steps in the on-going process of development in the Northern Zone but that they should be programmed and implemented in that context. We do not agree, however, with the attempt in part (c) of the

recommendation to link financing of a proposed Northern Zone Consolidation Project with the settlers signing repayment agreements with IDA. Moreover, the Mission does not agree with subpart (b) of Recommendation No. 1 unless the qualifying words, "reprogram as required", are inserted.

We recommend that USAID/Costa Rica:

- a. obtain evidence that the Government of Costa Rica has made arrangements for maintaining the road built under this project,

The Mission will solicit a letter from MOPT outlining the responsibilities for road maintenance. It should be noted that a component of the proposed Northern Zone Consolidation Project is the maintenance of the trunk road.

- b. deobligate or reprogram \$82,000 from the project coordination and development studies component, and

The Mission's first priority in using these funds will be for development studies. In the event that not all funds are required for this purpose, the plan is to use the funds in the community development component.

- c. obtain evidence that the Agrarian Development Institute has signed agreements specifying loan repayment terms and what further services settlers under the land purchase and titling component may expect from the institute, as a precondition to financing the planned Northern Zone Consolidation Project.

An agreement is already signed to provide for obtaining the settlers' signatures on repayment agreements. However, even with this agreement the plan could take a year to eighteen months to fully implement. We suggest serious consideration be given to rewording the recommendation so as to require that a plan be developed and monitored by the Mission as discussed in the accompanying transmittal letter.

Discussion

- Road Construction

This section of the report states (pages 8 and 9) that the 152 kilometer road component was reduced because of (1) contracting delays, (2) inaccurate cost estimating, and (3) cost escalation. However, it should be noted that redesign of two sections of the proposed project trunk road resulted in increasing the number of beneficiaries while reducing the overall length of the road by nearly 17 kilometers. This is an indicator of significant accomplishment rather than underachievement as alluded to in the report.

The second paragraph of page 9 of the report makes a comparison between the cost of the original project design (in terms of cubic meters of earth to be moved) and the final road design. This comparison is not valid because of the redesign of two sections of the trunk road. The redesign was made to increase the number of beneficiaries. Consequently, the conclusion that inaccurate cost estimating is one of the reasons for results having been less than planned is not valid. This comparison should be eliminated from the final report.

- Project Coordination and Area Development Studies

Page 14 of the report states in the first paragraph that \$82,333 is available for reprogramming because only \$167,667 out of the \$250,000 for this project component would be needed to pay for the studies and pilot projects already approved (Exhibit 3).

Efforts toward maximum achievement of the project purpose would be reduced by deobligation or reprogramming of the \$82,333 from the feasibility studies and pilot projects components. Largely as a result of continuous effort on the part of Mission management, this component has begun to move forward under the current MIDEPLAN Project Director. Of the \$167,667 in AID funds disbursed or committed, 53% has been committed during the past six months. The MIDEPLAN Project Coordinating office is now participating with beneficiaries in the elaboration of the following projects:

1. Development of Wind Brakes and Macadamia Nurseries in Bijagua - Total estimated cost	\$ 35,000
2. Improved Cacao Production through Selection and Grafting - Total estimated cost	65,000
3. Second Phase of Black Pepper Production - Total estimated cost	10,000
4. Feeder Pigs on the Small Diversified Farm - Total estimated cost	45,000
	<u>\$155,000</u>

The AID dollar input from 041 Loan funds is estimated at \$ 77,500

Deobligating or reprogramming \$82,333 from a component, which has taken on significant signs of recuperation, is inconsistent with recommendations that the Mission take extended actions with respect to supplementary activities in road maintenance and management of IDA settlements.

- Land Purchase and Titling

The Mission has no comments on this section of the draft audit report.

- Community Development

The Mission has no comments on this section of the draft audit report.

- Impact of Implementation Problems

The second paragraph of this section (page 18 of the draft) erroneously concludes that since 45 kilometers of planned roads will not be built with project funds, fewer residents will have all-weather access. The Mission insists that this is a factual error. The project paper indicated that 35,000 area residents would have all-weather access to markets and services. With the two design changes, however, 38,000 people will have access. These figures can be verified by a recent study conducted by sociologist in anticipation of the Northern Zone Consolidation Project. Consequently, the assertion made by the auditors that fewer people will have access to all weather roads because of less kilometers being built is not true. The statement that no one knows exactly how many people would have benefited from these 45 kilometers of roads is irrelevant because such figures can only be estimated and never stated with precision.

2. Further Actions Were Needed to Minimize the Project's Adverse Environmental Effects.

The Mission's comments on this section of the draft audit report (which starts on page 25) are included below.

Recommendation No. 2

- a. We recommend that USAID/Costa Rica obtain evidence that the Government of Costa Rica has funded the planned hydrologic and flora and fauna studies with its own resources and made a commitment to take appropriate actions based on the results of these studies, before funding the planned Northern Zone Consolidation Project.

The hydrologic and flora and fauna studies have already been signed and copies provided to RIG/A/T on November 30, 1987. The study is funded with dollars until the April 1988 PACD. To close out the recommendation, the Mission plans to obtain a letter from MIDEPLAN regarding their intention to continue funding the studies until 1989 and to take appropriate actions on any recommendations once the studies are concluded. The action to be taken will be better defined in the environmental assessment of the Northern Zone Consolidation Project.

- b. We recommend that USAID/Costa Rica obtain evidence that the Agrarian Development Institute has adopted land purchasing procedures which protect forested lands, before approving any further land purchases under the Northern Zone Infrastructure Project.

The Mission plans to send a letter to IDA stating that no land purchased with remaining funds will be approved if the property has more than 10-15% in primary forest whether or not high-graded. The Mission would expect assurance from IDA and the settlers that the land presently in primary forest remains as a forestry reserve, irrespective of its agricultural potential.

Discussion

The discussion section for finding number 2 begins on page 25, but the Mission has no comments until page 28.

On page 28, the last 3 sentences of the first paragraph do not flow from the preceding discussion on flora and fauna studies. Further, it is inconsistent within itself stating on one hand that project staff responsible for contracting the studies did not place sufficient importance on their accomplishment and then stating that USAID/Costa Rica made many attempts to get the studies approved. The Mission believes that "sufficient importance" is a comment too subjective for purposes of the scope of the audit.

B. Compliance and Internal Control

The Mission has no comments on this section of the draft audit report.

C. Other Important Matters

The Mission has no comments on this section of the draft audit report.

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