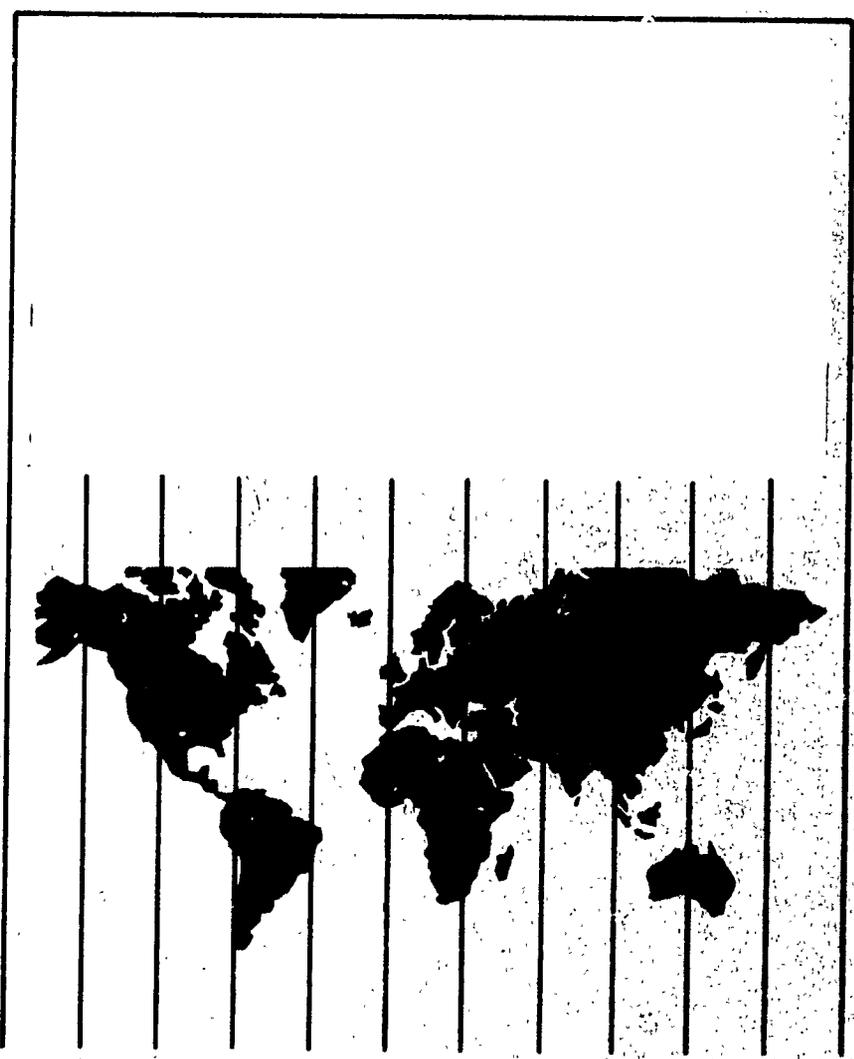


FD-101-542
101 23502

UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit
SINGAPORE

PD 130-042

AUDIT OF THE
FERTILIZER DISTRIBUTION IMPROVEMENT
PROJECTS IN BANGLADESH
PROJECT NOS. 388-0024 AND 388-0060

AUDIT REPORT NO. 5-388-90-02

OCTOBER 16, 1989

The projects were successful in increasing the availability and use of fertilizer and in involving the private sector in the distribution. However, since one of the project's credit programs may no longer be needed, \$9.5 million could be reprogrammed. Problems were also found with the maintenance and use of warehouses constructed with A.I.D. funds.

AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL FOR AUDIT
- Singapore -

U.S. POSTAL ADDRESS:
American Embassy
AID/RIG
FPO San Francisco 96699

INTERNATIONAL ADDRESS:
c/o American Embassy
30 Hill Street
Singapore 0617
Tel: 225-1033

October 16, 1989

MEMORANDUM FOR Priscilla M. Boughton, Director,
USAID/Bangladesh
FROM: *Alfred M. Clavelli*
Alfred M. Clavelli, Acting RIG/A/Singapore
SUBJECT: Audit of the Fertilizer Distribution
Improvement Projects in Bangladesh, Project
Nos. 388-0024 and 388-0060 (Audit Report No.
5-388-90-02)

The office of the Regional Inspector General for Audit/Singapore completed its audit of the Fertilizer Distribution Improvement Projects. Enclosed is the final report for your review and appropriate action.

The comments you provided based on the draft report are summarized after each finding and included in their entirety as Appendix 1 to this report. Based on your comments, Recommendation No. 2.e. and 2.g. have been closed. Recommendation 1 and the remaining parts of Recommendation 2 are considered resolved and will be closed upon completion of planned actions. Please advise me within 30 days of the additional action taken to implement the recommendations.

I certainly appreciate the cooperation and courtesy extended to the audit staff during the review and the prompt actions taken to respond to the report findings and recommendations.

EXECUTIVE SUMMARY

A.I.D. obligated \$259.6 million and expended \$228.6 million (as of June 30, 1989) for the two **Fertilizer Distribution Improvement Projects**. These projects were designed to help develop private sector involvement in the fertilizer distribution system in Bangladesh. The first project was authorized in July 1978 and completed in June 1988. The second project began in August 1984 and is expected to end in September 1991.

Our office made a performance audit to determine the extent project objectives were being accomplished, the adequacy of procedures and controls for the project's credit programs, and whether A.I.D.-funded fertilizer warehouses were being adequately maintained and used. The audit found that progress was being made despite resistance by the Government's implementing agency to many project activities. Use of fertilizer and the involvement of the private sector in fertilizer distribution was increasing. However, the following two problems were noted:

- Approximately \$9.5 million available for one of the two credit programs may no longer be required for this purpose and could be redirected to other more needed project activities.

- A.I.D.'s \$65 million investment in 61 fertilizer warehouses was jeopardized because they were not being properly maintained or disposed of, in excess to needs. For example, while about \$1 million was needed annually to maintain the warehouses, only \$200,000 was provided. Also, 17 warehouses were not in use at the time of our audit, and there were no plans for disposal.

To correct these problems, the report recommends USAID/Bangladesh (1) reassess the need for the in-kind credit program to meet project objectives and (2) take stronger actions to ensure the Government of Bangladesh adequately maintains or disposes of the A.I.D.-funded warehouses. USAID/Bangladesh agreed with the report findings and recommendations and was taking actions to implement the recommendations. Their comments are summarized after each finding and presented in their entirety as Appendix 1.

Office of Inspector General

AUDIT OF THE
FERTILIZER DISTRIBUTION IMPROVEMENT
PROJECTS IN BANGLADESH
PROJECT NOS. 388-0024 AND 388-0060

TABLE OF CONTENTS

	<u>Page</u>
PART I - INTRODUCTION	1
A. Background	1
B. Audit Objectives and Scope	3
PART II - RESULTS OF AUDIT	5
A. Findings and Recommendations	7
1. USAID/Bangladesh Should Reassess Continued Funding of The In-Kind Credit Program.	7
2. USAID/Bangladesh Needs to Take Stronger Action to Ensure A.I.D.-Funded Warehouses Are Effectively Used and Maintained, or Disposed of Properly.	14
B. Compliance and Internal Control	27
C. Other Pertinent Matters	29
PART III - EXHIBITS AND APPENDICES	
A. Exhibits	
1. Summary of Actions Taken by USAID/Bangladesh on Warehouse Maintenance and Utilization Problems	

2. Summary of Conditions of Warehouses Visited by Auditors
3. Summary of USAID/IFDC Inspection of 14 Warehouses

B. Appendices

1. USAID/Bangladesh Comments
2. List of Report Recommendations
3. Report Distribution

AUDIT OF THE
FERTILIZER DISTRIBUTION IMPROVEMENT
PROJECTS IN BANGLADESH
PROJECT NOS. 388-0024 AND 388-0060

PART I - INTRODUCTION

A. Background

The Fertilizer Distribution Improvement Projects were long-term efforts designed to increase use of fertilizer through a more responsive and cost-effective distribution system involving the private sector. The first project (388-0024) was authorized in July 1978 and completed in June 1988. The second project (388-0060) began in August 1984 and is expected to end in September 1991.

Under the first project, assistance was provided mainly for financing fertilizer imports, constructing warehouses, and developing a new marketing system. The second project concentrated on policy reform and credit programs for wholesalers. Both projects were implemented by the Bangladesh Agricultural Development Corporation (Corporation), a statutory corporation under the Government's Ministry of Agriculture. Primary technical assistance was provided through a host country contract with the International Fertilizer Development Center, an international nonprofit organization headquartered in Muscle Shoals, Alabama.

The total cost of the first project was \$222 million and the authorized cost of the second was \$65 million. As of June 30, 1989, USAID/Bangladesh obligated \$37.6 million for the second project and expended \$6.6 million.

As shown below, most project funds were used for technical assistance, warehouse construction, fertilizer and seed imports, and credit.

A.I.D. Obligations and Expenditures

As of June 30, 1989 (in \$000)

<u>Project Element</u>	<u>Obligations</u>	<u>Expenditures</u>
<u>Project 388-0024</u>		
Fertilizer Imports	\$140,425	\$140,370
Warehouse Construction	56,232	56,232
Technical Assistance	13,482	13,482
Seeds	11,418	11,418
Marketing Systems Improvement	460	460
Contingency	<u>6</u>	<u>6</u>
Total Project 388-0024	<u>\$222,023</u>	<u>\$221,968</u>
<u>Project 388-0060</u>		
Credit Programs	\$ 28,000	\$ 3,484
Technical Assistance	7,210	3,140
Construction/A&E Services	1,200	0
Training and Studies	950	0
Evaluation and Audits	<u>250</u>	<u>0</u>
Total Project 388-0060	<u>\$ 37,610</u>	<u>\$ 6,624</u>
Total For Both Projects	\$259,633 =====	\$228,592 =====

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit, Singapore conducted a performance audit of the Fertilizer Distribution Improvement Projects in Bangladesh. Audit objectives were to determine (1) the extent project objectives were being accomplished, (2) the adequacy of procedures and controls for the project's credit programs, and (3) whether A.I.D.-funded warehouses were being adequately maintained and used.

The audit, conducted from April through July 1989, included a review and analysis of project papers, evaluation reports, progress reports, and other relevant documents. Interviews were held with USAID/Bangladesh, the technical assistance contractor, and Government of Bangladesh officials in Dhaka. During a one-week period, visits were also made to 17 locations in Bangladesh to inspect 7 A.I.D.-funded warehouses and interview fertilizer wholesalers/dealers and government fertilizer distribution officials. The locations visited were selected in consultation with USAID and technical assistance contractor officials.

To determine the extent project objectives were being accomplished (the first audit objective), we reviewed the July 1988 final evaluation report on the first project and various monitoring reports on project activities prepared by the technical assistance contractor. We also interviewed USAID, technical assistance contractor, Government of Bangladesh, and private fertilizer wholesaler/dealer officials to obtain their views on project progress and problems.

The second audit objective, concerning the adequacy of the project's credit programs, was accomplished by reviewing the Corporation's in-kind credit procedures and financial reports; interviewing Corporation, technical assistance contractor, and USAID officials; and interviewing private fertilizer dealers. The project's commercial credit program was not reviewed since it was in the initial stage of implementation.

The third objective was to determine whether A.I.D.-funded warehouses were being adequately maintained and used. We inspected 7 of the 61 A.I.D.-funded warehouses; reviewed prior USAID and technical assistance contractor reports on warehouse maintenance and use problems; obtained information on the Corporation's warehouse maintenance program and resources allocated for maintenance; and interviewed appropriate USAID, technical assistance contractor, and Corporation officials.

The audit covered the period July 1978 to June 1989. Expenditures for the period were \$228.6 million. For the first project, the audit focused mainly on the warehouses constructed with A.I.D. funds amounting to over \$65 million. The audit covered all project activities under the second project. The reviews of compliance and internal controls were limited to the issues raised in this report. However, the Mission's overall system for ensuring project evaluation report recommendations were appropriately resolved and implemented was reviewed as part of this audit. The audit was made in accordance with generally accepted government auditing standards.

PART II - RESULTS OF AUDIT

Despite resistance from the Government of Bangladesh's implementing agency, the Fertilizer Distribution Improvement Projects were moving towards achieving project objectives. The first project helped increase the availability of fertilizer in Bangladesh by constructing warehouses and financing fertilizer imports. The project also succeeded in establishing a nationwide system of private wholesalers and retail dealers. Positive results were also being achieved under the second project. For example, according to technical assistance contractor monitoring reports:

- Fertilizer consumption increased significantly during the last two years, showing a 17 percent increase during the current government fiscal year over the 1986/87 fiscal year.
- Private sector involvement in fertilizer distribution also increased significantly. During May 1989, private distributors accounted for over 50 percent of sales of the major type fertilizer used in Bangladesh. Just three months previously, all fertilizer of this type was distributed by the government.

The need for continued funding, however, of the project's in-kind credit program should be reassessed. The project's commercial credit program was in the initial stages of implementation and it was too soon to assess results. Also, the fertilizer warehouses constructed with A.I.D. funds were not adequately maintained, and many were not effectively used.

USAID/Bangladesh's management of the projects, although generally adequate, could be improved. Therefore, the report recommends that USAID/Bangladesh reassess the need for continued funding on the project's in-kind credit program and consider possible alternative uses for the remaining \$9.5 million in unspent funds. The report also includes recommendations to better ensure the A.I.D.-funded warehouses are adequately maintained and used.

A. Findings and Recommendations

1. USAID/Bangladesh Should Reassess Continued Funding of The In-Kind Credit Program.

USAID/Bangladesh is continuing to fund the in-kind credit program which, due to recent host country policy changes, may no longer support project objectives. A.I.D. Handbook regulations state that project resources must be utilized to produce intended benefits. USAID/Bangladesh is concerned that cancelling the credit program may hamper progress in meeting project objectives. As a result, \$9.5 million in unexpended funds has not been reprogrammed for other project uses that may more fully support project objectives.

Recommendation No. 1

We recommend USAID/Bangladesh:

- a. Limit the in-kind credit program to the \$3.5 million disbursed and deobligate/reprogram the remaining \$9.5 million unless it can be clearly demonstrated that continued funding of the program will significantly contribute to meeting project objectives.
- b. Inform the Government that the funds currently in the revolving fund can and should be used for loans, even if no additional funds are provided.

Discussion

USAID approved the Bangladesh Agriculture Development Corporation's (Corporation) in-kind credit program in 1986 and obligated \$13 million. Under the in-kind program, the Corporation provides credit to wholesalers for fertilizer purchases. The Corporation draws on a special account based on these credit sales. When the wholesalers pay the Corporation, the funds are deposited in an interest-bearing revolving account and used to provide additional credit to finance the in-kind credit program.

USAID funding for this program was limited. No funds were provided until November 1988. Also, even after \$3.5 million was provided, it was not used because the Corporation operated the program with its own resources and because the Corporation did not believe any of the USAID funds already provided could be used until USAID disbursed the full \$13 million.

In May 1989, the Corporation requested USAID to provide an additional \$7 million for the program. As discussed below, we do not believe these funds should be provided.

Current Need for The In-Kind Credit Program - Due to recent changes in Bangladesh's fertilizer distribution system, continued funding of the in-kind credit program may no longer support project goals. The Corporation's experience to date with the program indicates limited demand for this credit program. Also, the \$3.5 million USAID disbursed for the program was not used for credit purposes but instead remained idle in the Corporation's credit revolving fund. Since there are better alternative uses for the remaining \$9.5 million

obligated for the in-kind credit program, the funds should be reprogrammed.

When USAID approved the in-kind credit program in 1986, all fertilizer sales were made from the Corporation's outlets. However, the fertilizer distribution system recently changed dramatically -- moving away from the Corporation's outlets towards the more efficient private sector's distribution system. For example, in 1986, when the credit program was approved, all fertilizer was distributed from the Corporation's 75 primary outlets. According to project officials, this system was not efficient due to the large number of outlets which were not strategically located near factories, ports, or major transportation hubs. The Corporation was, therefore, incurring excessive transportation, handling, and storage costs.

Starting in 1988, the project was successful in getting the Government of Bangladesh to establish more efficient and cost effective distribution outlets. First, the Government opened larger Corporation discount outlets near transportation hubs and factories. Then, in April 1989, the Government allowed wholesalers to buy fertilizer directly from two of the five fertilizer factories. At the close of our audit, the Government was considering allowing wholesalers to buy imported fertilizer directly from the ports.

The efforts to make the fertilizer distribution system more cost effective may eliminate the need for additional funding for the in-kind credit program for the following reasons:

-- The Corporation's experience with the program since 1986 indicates demand is limited. For example,

although the Corporation envisioned that (within six months of implementation) over 5,000 dealers would take part in the program and credit requirements would reach \$20 million, results to date have been well below expectations. Since 1986, according to Corporation reports, only an average of about 130 dealers annually took advantage of in-kind credit, and credit demand never reached more than \$2 million at any one time.

-- The in-kind credit program is available only at Corporation outlets so it does not benefit wholesalers buying fertilizer from factories or importing fertilizer. Sales at these locations are expected to account for a large portion of the fertilizer sold. Sales at the two factories, for example, accounted for over 50 percent of the total sales of this type fertilizer in May 1989, according to the technical assistance contractor's monitoring reports.

-- While the in-kind credit will be available to wholesalers buying from the larger Corporation discount outlets established in 1988, wholesalers will also have access to the project's commercial credit program at these locations. The need for two credit programs to facilitate sales at these outlets is questionable. Further, as the Government opens more outlets at factories and ports, the need for the Corporation discount outlets will lessen.

A further indication that additional USAID funding for this program is not warranted is the fact that the \$3.5 million provided by USAID to date was not used by the

Corporation for credit purposes. Instead, the Corporation deposited the funds in the credit program's revolving fund which has not been used to fund credit. The Corporation believed that USAID must disburse the entire \$13 million obligated for the credit program before it could use the revolving fund for credit. Thus, the \$3.5 million disbursed by USAID remained idle.

There may be alternative uses for the \$9.5 million obligated for the in-kind credit program which could better contribute to achieving project objectives. For example, the project funds a commercial credit program which is more in line with project objectives. This credit program also provides more flexibility to private wholesalers than the in-kind credit program.

Although events have changed since the in-kind credit program was approved, USAID is reluctant to cancel the program agreed to under the Government's previous distribution policy. In fact, USAID previously encountered considerable difficulty in obtaining support for this program. USAID officials believe that there continues to be a need for an in-kind credit program to encourage private sector purchases from Corporation outlets, particularly for imported fertilizer, sold at the ports. In addition, they believe that to withdraw support so soon after funding the program would be disruptive to the project as a whole by possibly causing the Corporation to resist other project efforts.

A.I.D. Handbook regulations state project resources should be used to support project purposes. We believe events have changed so significantly since the credit program was approved that the program is no longer supportive of project purposes. Thus, the program should be limited to the \$3.5 million already disbursed

unless it can be demonstrated that continued funding will significantly benefit project objectives.

USAID officials also need to ensure that the Corporation uses the \$3.5 million already provided for loan purposes. Should USAID decide to continue funding any part of this program, it should ensure the Corporation fully uses the revolving fund account before requesting additional funds. Any such requests should clearly demonstrate the need for additional funding.

Management Comments

USAID/Bangladesh concurred with the finding and recommendations (see Appendix 1 for full text of comments). They stated that part (a) of Recommendation No. 1 provided the Mission with a valuable critique of the in-kind credit program which led them to initiate a critical reassessment of the program. According to USAID/Bangladesh, a local accounting firm, hired in July 1989 to conduct a financial review of the credit program, concluded the program was adequately capitalized and recommended no additional funds be disbursed at this time. USAID/Bangladesh indicated a project review committee will meet during October 1989 to discuss the accounting firm's report and forward a recommendation to the Mission Director as to how the Mission should proceed with regard to in-kind credit.

Concerning part (b) of the recommendation, USAID/Bangladesh stated they would send the Government of Bangladesh a letter clarifying their understanding on the use of the \$3.5 million already disbursed and advising the Government that these funds should be used for in-kind credit without further delay.

Office of Inspector General Comments

Based on USAID's comments, Recommendation No. 1 is considered resolved. Part (a) of the recommendation can be considered for closure after we are provided the results of the project review committee's review of the in-kind program, and the Mission Director's decision concerning USAID funding of the in-kind credit program. Part (b) can be closed after we are provided a copy of USAID/Bangladesh's letter to the Government of Bangladesh.

2. USAID/Bangladesh Needs to Take Stronger Actions to Ensure A.I.D.-Funded Warehouses Are Effectively Used and Maintained, Or Disposed of Properly.

The Government of Bangladesh was not properly maintaining or using A.I.D.-funded warehouses. This occurred because USAID, despite repeated attempts, has not yet succeeded in getting the Government to implement an adequate maintenance program. Also, USAID and the Government have yet to reach agreement on alternative uses or to dispose of the warehouses no longer needed for fertilizer storage. Consequently, 61 warehouses built with \$65 million in USAID funds were deteriorating and at least 17 of these, costing \$8 million, were vacant or underutilized.

Recommendation No. 2

We recommend USAID/Bangladesh:

- a. Require the Government to develop a plan to adequately maintain A.I.D.-funded warehouses. The plan should indicate the type and frequency of maintenance activities at each warehouse and the amount of funds needed.

- b. Determine whether the 14 underutilized A.I.D.-funded warehouses being retained by the Government can be effectively used for seed storage and adequately maintained. If not, the Mission should require the Government to find better alternative uses or dispose of the warehouses.

- c. For the other three underutilized A.I.D.-funded warehouses located at Santahar and Rangpur, require the Government to (1) release the warehouses for other uses, or (2) provide documentation justifying that the warehouses are still needed and will be adequately maintained.
- d. Require the Government to submit a plan for USAID/Bangladesh's review and approval, on how the five A.I.D.-funded warehouses, located at the primary distribution points closed or merged with other distribution points on July 1, 1989, will be disposed of or used.
- e. At least semi-annually meet with Government and technical assistance contractor officials to (1) review operations of the Government's primary distribution points, (2) determine based on agreed upon criteria which locations should be closed, and (3) establish timetables for closing the locations, if warranted.
- f. Require the Government to develop a plan for alternative uses for those A.I.D.-funded warehouses expected to be released by the Government over the next two years, including the possible sale or lease of the warehouses to the private sector.
- g. Develop a plan for annually inspecting the A.I.D.-funded warehouses to verify that the warehouses are being adequately maintained and used.
- h. Advise the Government that should there be noncompliance with the various parts of this recommendation or if annual inspections reveal that the warehouses are not being adequately maintained

and/or effectively used, USAID/Bangladesh will seek to recover, in accordance with the project agreement, all or part of the warehouse construction costs.

Discussion

The Bangladesh Agriculture Development Corporation (Corporation) had an inventory of 195 warehouses. USAID funded 61 of these at a cost of over \$65 million. These warehouses were constructed in three phases: 27 phase-I warehouses were completed in 1980, 26 phase-II warehouses in 1984, and 8 phase-III warehouses in 1986.

The Government of Bangladesh was responsible for ensuring that the A.I.D.-funded warehouses were effectively maintained and used. In accordance with the project agreement, USAID can obtain refunds should these conditions not be met.

As shown in Exhibit 1, USAID officials have been urging the Government of Bangladesh to address warehouse maintenance and utilization problems. In June 1988, for example, USAID met with and sent letters to the Ministries of Agriculture and Food to press for a solution, including possible transfer or sale of warehouses. In September 1988, the technical assistance contractor, at USAID's request, issued a draft warehouse maintenance manual for the Corporation's review and comment. Most recently, in June 1989, Bangladesh Government officials agreed to provide by early July a detailed plan for either transferring the warehouses to other government agencies or selling the warehouses to the private sector. However, more still needs to be accomplished.

Maintaining Warehouses - Audit visits during May 1989 to seven A.I.D.-funded warehouses disclosed that the Corporation was not maintaining the warehouses. No maintenance program was implemented for the seven warehouses, and only two warehouses received any maintenance during the last 12 months.

We found, however, that six of the seven warehouses visited required major maintenance and repairs (see Exhibit 2 for details). For example, the Phase I warehouse inspected at Rangpur, constructed at a cost of \$270,000 in 1980, was not being maintained. The warehouse showed signs of rapid deterioration -- the cement floor was breaking up, the loading dock was breaking away, and doors were rusting. Also, bags of fertilizer stored at the warehouse for over 18 months were dissolving and causing damage.

The following pictures show examples of the type maintenance/repair problems found at two other locations visited.

Examples of Maintenance/Repair Problems Observed at
A.I.D.-Funded Warehouse at B. Baria



Ground under rear of
warehouse washed away by
1988 floods.



Walls of warehouse need
repainting.

Examples of Maintenance/Repair Problems at
A.I.D.-Funded Warehouse at Comilla



Broken electrical pole.
60 percent of electricity
for warehouse complex not
working.



Warehouse walls cracked.

USAID/Bangladesh was aware of warehouse maintenance problems as a result of various reports. For example:

- A June 1986 final completion report, prepared by the engineering consulting firm for the phase-III warehouses, stated that there was a lack of maintenance of phase-I and -II sites and recommended a maintenance program be set up and implementation monitored for each site.

- The July 1988 final evaluation report on the first fertilizer project concluded that the A.I.D.-funded warehouses were being poorly maintained. The report stated problems being encountered included leaking roof joints, roof cracks, floor subsidence, and wall cracks.

- A November 1988 report on the results of a joint inspection of the utilization and condition of 14 phase-I warehouses (performed by USAID and the International Fertilizer Development Center (IFDC), the project's technical assistance contractor) concluded that no maintenance work was done at any of the sites inspected after construction was completed in 1980. The inspection found all 14 sites needed work on electrical lines, water supply, plumbing and toilet renovation and repairing, painting of building walls and doors, windows, entrance gates, barbed wire fencing, and construction of boundary walls.

IFDC, at USAID's request, prepared a draft warehouse maintenance manual outlining the types of routine preventive work required and submitted the manual to the Corporation for comment in September 1988. At the close

of our audit, however, the Corporation had taken no actions on the manual.

Corporation officials attributed the lack of warehouse maintenance to financial constraints. They estimated about \$1 million (Taka 35 million) was needed annually to maintain the existing inventory of 195 warehouses. However, only about \$200,000 (Taka 6.5 million) or about 20 percent of the required amount was budgeted for repair and maintenance in the current fiscal year. The officials indicated that they prioritized repair and maintenance requirements and only financed repair work at 21 warehouses, leaving about \$41,000 to maintain the other 174 warehouses or \$235 per warehouse.

Besides lacking financial resources, the Corporation also did not have any plan to carry out routine or preventive maintenance work at its warehouses. Such maintenance work is needed to prolong the life of the warehouse and avoid the need for major repair work which the Corporation is now faced with financing.

Actions must be taken quickly to ensure A.I.D.'s \$65 million investment is protected since many warehouses were showing advanced signs of deterioration from lack of maintenance. The Government is now faced with finding adequate resources to "catch up" with long neglected maintenance and increased difficulties in finding alternative uses or selling unneeded warehouses.

Fourteen A.I.D.-Funded Warehouses Released by The Corporation Should Be Effectively Utilized and Maintained - In 1985, the Corporation determined that 14 of the 27 phase-I warehouses were excess to its fertilizer distribution needs and released the

warehouses for other uses. From October 1988 to January 1989, a joint USAID/IFDC team inspected the 14 warehouses and found that the warehouses were mostly vacant or underutilized. For example, the team found that the warehouse located at Kalkini was basically vacant since it was constructed in 1980. (Exhibit 3 summarizes the utilization and condition of the 14 warehouses inspected by the team.)

USAID officials met most recently with Government of Bangladesh officials on June 8, 1989, to discuss the Government's plans for the 14 excess warehouses. According to USAID officials, the Government was considering selling the warehouses to the private sector and agreed to provide a detailed plan by July 1 on the disposition of the warehouses. The Government, however, subsequently decided to retain all 14 warehouses for seed storage. USAID/Bangladesh was in the process of analyzing the Government's decision at the close of the audit.

Based on Bangladesh's failure to effectively use and maintain the 14 A.I.D.-funded warehouses released in 1985, USAID must carefully evaluate the Government's decision to retain these warehouses. In particular, USAID must determine whether the warehouses can be effectively used for seed storage and whether the Government's Seed Corporation can maintain the warehouses. If USAID determines the warehouses cannot be effectively used or maintained, it should (1) require the Government to either find acceptable alternative uses or sell the warehouses, or (2) seek refunds for the warehouse construction costs.

The Corporation Should Release A.I.D.-Funded Warehouses That Have Other Uses - Based on changes in the fertilizer distribution system, it was anticipated that the Corporation could close many of its existing wholesale outlets and thereby release many A.I.D.-funded warehouses for other uses. This did not occur because the Corporation resisted some changes and was reluctant to release unneeded warehouses. However, because of dramatic changes taking place with the distribution system, actions must be taken to ensure A.I.D.-funded warehouses no longer needed are released and that alternative uses are found for these warehouses.

In early 1988, the Corporation opened several discount outlets which provided fertilizer to wholesalers at prices below those charged by the primary outlets due to lower transportation, handling, and overhead costs. Also, in April 1989, the Government of Bangladesh began selling urea fertilizer to wholesalers directly from two of the five domestic urea factories. The discount outlets and factory direct sales program were expected to eliminate the need for many of the old primary outlets.

Although the Corporation agreed to close its old outlets should sales fall drastically and several qualified for closing, none were closed. The Corporation was reluctant to close outlets because it would have had to find jobs for the displaced employees.

USAID did not press for closure since it was difficult to evaluate the true effects of the distribution changes. For example, the Corporation had agreed to close its old outlets if sales fell below a certain level. During 1988, however, the Corporation restricted operations of the discount outlets forcing wholesalers

to continue to use the old outlets. Thus, the old outlets' sales figures were distorted, causing few to qualify for closing.

There is considerable evidence that the Corporation is retaining outlets supported by A.I.D.-funded warehouses which should be closed. For example,

- In addition to inspecting the 14 phase-I warehouses released by the Corporation in 1985, the USAID/IFDC team in January 1989 inspected two warehouses (phase-I and -II) costing over \$6 million at a remote outlet (Santahar). The inspection found that the outlet was only selling a small amount of fertilizers because of competition from the new discount outlet operations.

- All seven outlets visited by the auditors during May 1989, reported virtually no sales of domestically produced fertilizer during the month. The lack of sales was attributed to the factory direct sales program.

In view of the substantial reduction of primary outlets sales, a more frequent review of their operations is warranted. USAID and the Government of Bangladesh also need to better define the criteria for closing the primary points. One condition for closure action - when sales fall "drastically" - is open to interpretation. Therefore, USAID should meet at least semi-annually with the Corporation to (1) review primary outlet operations, (2) determine based upon an agreed-upon criteria which locations should be closed, and (3) establish a timetable for closing the locations, if warranted.

Efforts must also be taken as quickly as possible to find alternative uses for the A.I.D.-funded warehouses located at the old outlets. Simply releasing them from the Corporation's control does not guarantee effective use. As previously discussed, the 14 warehouses released by the Corporation in 1985 were not being effectively used or maintained.

It probably will be even more difficult for the Government to find alternative uses for the remaining A.I.D.-funded warehouses because these warehouses were significantly larger than the 14 released in 1985. The majority of remaining warehouses ranged from 2,000 to 8,000 metric tons capacity, whereas the 14 previously released were all only 500 metric tons with the exception of one 1,000 metric ton warehouse. Therefore, advance planning is critical.

At the close of our audit, the Government of Bangladesh was finalizing actions to address the problem of excess warehouse capacity. In a meeting with USAID officials on June 8, 1989, Government officials indicated that 15 primary outlets would be closed on July 1, 1989, and that closing and disposal plans would be submitted. (There are five A.I.D.-funded warehouses located at these primary outlets.) However, the Corporation provided no information on whether it planned to dispose of the closed warehouses or find alternative uses for them. Such information is required to assure the A.I.D.-funded warehouses will be effectively used and adequately maintained.

Management Comments

USAID/Bangladesh agreed with the recommendation and was taking appropriate actions to implement the various parts. The full text of their comments is presented in Appendix 1.

Office of Inspector General Comments

Based on USAID's comments, parts (e) and (g) are considered closed upon issuance of this report. The other parts of the recommendation are resolved and can be closed when the appropriate actions are taken.

B. Compliance and Internal Control

Compliance

The following compliance issues are discussed in the audit finding sections:

- The Government of Bangladesh did not comply with special project covenant 6.2 (d) which required that it execute a maintenance program, acceptable to USAID, for all fertilizer warehouses constructed with A.I.D. funds.

- A condition precedent for the second disbursement of project funds required the Government of Bangladesh to establish discount outlets. Although this condition precedent was cleared in April 1988 after considerable difficulty, the Government's implementing agency, up to the time of our audit, never allowed these discount outlets to operate as envisioned. The agency continually understocked the locations and undertook other measures intended to discourage private wholesalers from buying fertilizer at the new outlets.

- By understocking the discount outlets, the Government of Bangladesh was also not complying with special covenant 6.2 (a) and (e) which required that it maintain adequate fertilizer stock levels for wholesale distribution.

Internal Control

The audit disclosed no material internal control weaknesses. Minor weaknesses in the Mission's system for resolving and implementing evaluation report recommendations were brought to the attention of the Mission officials during the audit.

The audit review of compliance and internal control was limited to the findings presented in this report, except for the review of the Mission's system for resolving and implementing evaluation report recommendations which was found to be adequate.

C. Other Pertinent Matters

USAID/Bangladesh can improve its monitoring and evaluation of the project by establishing targets (quantities and dates) for the various project objectives. Although an excellent management information system was developed and substantially adopted for the second project, we noted few targets had been established for various project elements or objectives. For example, a major project element involved providing credit to private fertilizer wholesalers. Since no targets had been established for such things as the date the credit programs were to be implemented, the number of dealers expected to participate and when, and credit recovery rates, it was difficult to assess the progress of the credit programs against expected results.

USAID and technical assistance contractor officials pointed out that the controversial nature of this complex policy project made setting realistic targets extremely difficult. While we recognize the controversial nature of the project and the need to avoid antagonizing the implementing agency, we also believe targets are needed to monitor and measure project progress and problems. Such targets could be established internally within USAID without involving the implementing agency. More importantly, as stated in the management information system report prepared for the project, until targets for each project objective are established, there cannot be any meaningful monitoring and evaluation system since there will be no expected results against which to measure the actual performance.

PART III - EXHIBITS AND APPENDICES

Summary of
 Actions Taken by USAID/Bangladesh On
Warehouse Maintenance and Utilization Problems

<u>Date</u>	<u>Action</u>
March-May 1988	USAID/Bangladesh surveyed fertilizer warehouses to evaluate utilization and maintenance conditions.
June 1988	USAID made suggestions to the Ministries of Food and Agriculture that excess warehouses be used for food storage.
July 1988	Follow-up letter sent to Ministry of Agriculture urging underutilized warehouses be made available for food storage.
September 1988	At USAID's request, IFDC issued draft maintenance manual for fertilizer warehouses to Bangladesh Agriculture Development Corporation for review and comment.
November 1988	Joint USAID/IFDC team inspected 14 vacant phase-I warehouses and issued report recommending warehouses be turned over to other agencies.
December 1988	USAID requested the Ministry of Agriculture to transfer 14 underutilized phase-I warehouses to the Ministry of Food for storage.
January 1989	USAID requested that the \$6 million A.I.D.-funded warehouse at Santahar be transferred to an agency that can utilize it.
February 1989	Ministry of Agriculture denied request for transferring warehouses stating the warehouses were needed for storing seeds and emergency fertilizer supplies.
April 1989	USAID met with principal Government officials in an attempt to resolve the problem of underutilized phase-I warehouses.
June 1989	USAID again met with Government officials at which time the officials agreed to provide by early July a detailed plan for either transferring or disposing of underutilized warehouses.
July 1989	Government of Bangladesh decided to retain 14 phase-I warehouse for seed storage.

SUMMARY OF CONDITIONS OF WAREHOUSES VISITED BY AUDITORS

<u>LOCATION</u>	<u>DATE CONST.</u>	<u>CAPACITY (MT)</u>	<u>CONST. COST</u>	<u>CONDITION OF WAREHOUSE</u>	<u>TYPE MAINTENANCE PROGRAM AT LOCATION</u>
B. Baria	1983	6000	\$1,511,277	Building needed painting. Experiencing elect. problems. Several electrical poles broken. Needed retaining wall. Serious problems in rear of warehouse with washed out soil.	No formal maint. program. Nothing spent for maint./ repair in last 12 months.*
Comilla	1984	8000	\$2,364,111	Building needed painting. 60 % of elect. not working. All outside lights broken. Warehouse floor sinking. Cracks in concrete. Broken water pump-no water.	No formal maint. program. Nothing spent for maint./ repair in last 12 months.
Feni	1979 1983	3000 3000	\$290,106 \$901,910	Warehouse roof leaked.	No formal maint. program. Nothing spent for maint./ repair in last 12 months.
Parbatipur	1985	4000	\$671,827	Roof leaked during heavy rain. Concrete walls beginning to show cracks.	No formal maint. program. Nothing spent for maint./ repair since warehouse constructed.
Rangpur	1980	3000	\$269,504	Warehouse was deteriorating rapidly. Cement floor breaking up, loading dock breaking away, doors rusting. Bags of fertilizer at warehouse for over 18 months dissolved causing damage. Warehouse only partially used to store fertilizer.	Only caretaker present since warehouse not used. obvious no maintenance was being done.

<u>LOCATION</u>	<u>DATE CONST.</u>	<u>CAPACITY (MT)</u>	<u>CONST. COST</u>	<u>CONDITION OF WAREHOUSE</u>	<u>TYPE MAINTENANCE PROGRAM AT LOCATION</u>
Mahendranagar	1984	12000	\$2,883,034	Engr. Dept. estimated Taka 497,000 required to bring warehouse maintenance up to date.	No formal maint. program. Spends about Taka 3000/ year for maint.
Bogra	1984	12000	\$3,108,025	Warehouse generally in good condition, although facility had no water.	No formal maint. program. Budgeted about Taka 3000 this year for maint. Last fiscal year had taka 10,000 budget.

*The Bangladesh Agriculture Development Corporation budgeted Taka 309,710 to construct a retaining wall and make other repairs at this site. The retaining wall was expected to be completed before the next floods.

- 73'

Exhibit 3

SUMMARY OF USAID/IFDC INSPECTION OF 14 WAREHOUSES

<u>NAME OF SITE</u>	<u>CAPACITY (MT)</u>	<u>COST</u>	<u>DATE INSP.</u>	<u>WAREHOUSE UTILIZATION</u>	<u>CONDITION OF WAREHOUSE/BLDGS</u>
Adamdighi	500	\$104,498	10/88	Vacant but may store seeds	Needs routine maint
Akkelpur	500	\$107,671	10/88	Vacant	Needs renovation/repair work
Araihazar	500	\$102,220	10/88	Vacant	Repair/renovation wk needed
Gabtali	500	\$105,198	10/88	Underutilized-some seed stored	Staff qtr deplorable/whse not maint
Ghoraghat	500	\$98,276	10/88	Vacant	Some repairs needed
Jhinaidah	500	\$111,828	10/88	Used as seed stores	Needs periodic maint.
Kalkini	500	\$110,456	01/89	Vacant-seed stored 10/88	Good cond/some flood damage
Monirampur	500	\$112,630	10/88	Underutilized-some seed stored	Generally good condition
Nandigram	500	\$107,967	10/88	Underutilized	Needs routine maintenance
Rupganj	500	\$94,748	10/88	Underutilized-some seed stored	Whse OK, staff qtrs needs repair
Saghata	500	\$99,347	01/89	Used to store raw jute	Repairs needed from flood damage
Shibpur	500	\$97,832	11/88	Used by Seed and Irrig. Depts	Routine maint needed
Srinagar	500	\$107,263	11/88	Underutilized-some seed stored	Routine repairs needed
Taltala	1000	\$156,539	11/88	Vacant	Needs periodic maint.
TOTAL	7500 =====	\$1,516,473 =====			

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
Dhaka, Bangladesh

September 20, 1989

MEMORANDUM

TO : Reginald Howard, RIG/A/Singapore
FROM : *J. M. Doughton*
Priscilla M. Doughton, DIR
SUBJECT : Audit of the Fertilizer Distribution Improvement
Projects in Bangladesh, Project Nos. 388-0024 and
388-0060 - Draft Report of August 1989.

The purpose of this memo is to address the audit recommendations included in the subject report. In summary, based on actions taken by the Mission to address the recommendations included in the draft report, the Mission requests closure of recommendations 1a, 2e and 2g. We believe that the remaining recommendations should be considered resolved. The Mission will request closure once the appropriate actions have been taken.

I wish to express the Mission's appreciation for the valuable input this audit provides towards improving our program. Specifically, I believe that recommendation 1a has provided the Mission with a valuable critique of the In-Kind Credit Program which has led the mission to initiate a critical reassessment of these resources to further project objectives.

Recommendation 1a

In July 1989, the Mission hired a local accounting firm to conduct a financial review of BADC's In-Kind Credit Program. This firm has completed its review and submitted its final report to USAID. A copy of this report has been provided to RIG/A/S by separate cover letter. The report finds that the In-Kind Credit Program is adequately capitalized at present and therefore recommends additional funds should not be released at this time. A Project Review Committee (PRC) meeting is scheduled for October 15, 1989 to discuss the report and forward a recommendation to the Mission Director as to how the Mission should proceed with regard to In-Kind Credit. As reported to RIG/A/S during the audit, USAID believes there continues to be a need for the In-Kind Credit Program. It does appear, however, that the level of this program can be significantly reduced from the original planned level of \$13.0 million to the \$ 3.5 million already disbursed. We will report to you the results of our assessment of the In-kind Credit Program

35

2

requirements following the PRC meeting. Depending upon the results of this meeting, USAID will undertake with the BDG a joint effort to reprogram funds to another activity consistent with the project purpose.

We will request the closure of recommendation 1a upon issuance of the final report.

Recommendation 1b

A letter to the BDG is being drafted, which will clarify our understandings on the use of the \$3.5 million already disbursed and advise them that these funds should be used for in-kind credit without further delay. A copy of the letter will be forwarded to RIG/A/S by separate letter.

Upon issuance of this letter, USAID will request closure of Recommendation 1b.

Recommendations 2 a, f and h

A letter to the BDG is being drafted, which will address these three recommendations. The letter will specify that the Ministry of Agriculture (MOA) and BADC are required to develop a maintenance plan for all A.I.D.-funded warehouses and to allocate sufficient resources to fully implement the plan. We will suggest that the BDG accept and implement the IFDC maintenance plan, which USAID has reviewed and found acceptable. We will be seeking assurance that funds will be made available to implement the maintenance plan agreed upon. The letter will remind the BDG of its obligations to maintain and fully utilize the warehouses, according to the Grant and Loan Agreement, Covenant 6.2 (d).

Regarding recommendation 2f, fifteen warehouses (including 6 A.I.D.-funded) warehouses were closed on July 1, 1989. A copy of the BADC order dated June 29, 1989 has been forwarded to RIG/A/S by separate letter. An internal BADC to MOA letter of June 10, 1989 identifies 15 warehouses for closure on July 1, 1990 and another 15 on July 1, 1991. Our letter to the BDG will request a plan of alternative use of those redundant warehouses which are A.I.D.-funded, including possible sale or lease to the private sector.

Following the issuance of the letter from USAID to BDG, we will request the closure of recommendations 2a, f and h. We will continue to report to RIG/A/S and provide a copy of BDG responses when received.

26

Recommendations 2b and d

A letter was sent to the MOA on August 15, 1989 suggesting that all surplus A.I.D.-funded warehouses be sold to the private sector and proposing a meeting to resolve the utilization of the 20 A.I.D.-funded warehouses that are currently surplus. A date for this meeting has not yet been set.

We will request the closure of these two recommendations upon receipt of either an agreement from the MOA to sell these 20 warehouses, or upon receipt of an acceptable maintenance plan (as required under recommendation 2a) in the event the MOA decides to retain them for seed storage or other purposes.

Recommendation 2c

At the time of the audit, the three warehouses in question at Santahar and Rangpur were underutilized and poorly maintained. These warehouses are now fully stocked with fertilizer in anticipation of BADC sales during the peak fertilizer season from September to April. They may, however, prove redundant in the near future if BADC sales continue to decline.

We will continue to monitor activities at these warehouses, and will request closure upon receipt of evidence from BADC that these warehouses have been released for other uses or upon receipt of acceptable documentation justifying that these warehouses should be retained and can be adequately maintained.

Recommendation 2e

The BDG satisfactorily met Condition Precedent 5.4(c) by agreeing to a criteria to close PDPs. It was agreed by USAID and the MOA to meet annually to review the annual sales data by PDP and, based on the accepted criteria, agree on closure. Two annual meetings were held in 1988 and 1989. In the 1988 meeting, the criteria was agreed upon and the CP was met. In the 1989 meeting, BADC agreed to administratively close 15 PDPs, after USAID pointed out that sales from many PDPs would have declined dramatically and met the criteria for closure if the TDPs had been allowed to operate freely without BADC interference to the contrary. Given the rapid pace of current activities under the program, USAID and BDG, as suggested by the audit, will hold two meetings during the next year to review current sales data. Decisions will be made based on agreed upon criteria, which warehouses can be closed and in what time frame. During the second meeting USAID and BDG will review the usefulness of a semi-annual meeting, versus an annual meeting and determine an appropriate meeting schedule for 1991. Accordingly, USAID requests that recommendation 2e be closed upon issuance of the final report.

- 37'

Recommendation 2g

We agree with this recommendation to conduct annual inspections of randomly selected A.I.D.-funded warehouses. Site visits will be conducted by USAID staff as well as IFDC staff. Problems observed will be duly reported to the SDG. USAID will prepare a checklist to facilitate random inspections by USAID and contract personnel. Written trip reports will be prepared and will be available for RIG/A/S review at USAID. Accordingly, USAID requests that recommendation 2g be closed upon issuance of the final report.

- 22

List Of Report Recommendations

Recommendation No. 1

We recommend USAID/Bangladesh:

- a. Limit the in-kind credit program to the \$3.5 million disbursed and deobligate/reprogram the remaining \$9.5 million unless it can be clearly demonstrated that continued funding of the program will significantly contribute to meeting project objectives.
- b. Inform the Government that the funds currently in the revolving fund can and should be used for loans, even if no additional funds are provided.

Recommendation No. 2

We recommend USAID/Bangladesh:

- a. Require the Government to develop a plan to adequately maintain A.I.D.-funded warehouses. The plan should indicate the type and frequency of maintenance activities at each warehouse and the amount of funds needed.
- b. Determine whether the 14 underutilized A.I.D.-funded warehouses being retained by the Government can be effectively used for seed storage and adequately maintained. If not, the Mission should require the Government to find better alternative uses or dispose of the warehouses.
- c. For the other three underutilized A.I.D.-funded warehouses located at Santahar and Rangpur, require the Government to (1) release the warehouses for other uses or (2) provide documentation justifying that the warehouses are still needed and will be adequately maintained.
- d. Require the Government to submit a plan for USAID/Bangladesh's review and approval, on how the five A.I.D.-funded warehouses located, at the primary distribution points closed or merged with other distribution points on July 1, 1989, will be disposed of or used.

- e. At least semi-annually meet with Government and technical assistance contractor officials to (1) review operations of the Government's primary distribution points, (2) determine based on agreed upon criteria which locations should be closed, and (3) establish timetables for closing the locations, if warranted.
- f. Require the Government to develop a plan for alternative uses for those A.I.D.-funded warehouses expected to be released by the Government over the next two years, including the possible sale or lease of the warehouses to the private sector.
- g. Develop a plan for annually inspecting the A.I.D.-funded warehouses to verify that the warehouses are being adequately maintained and used.
- h. Advise the Government that should there be noncompliance with the various parts of this recommendation or if annual inspections reveal that the warehouses are not being adequately maintained and/or effectively used, USAID/Bangladesh will seek to recover, in accordance with the project agreement, all or part of the warehouse construction costs.

Report Distribution

	<u>No. of Copies</u>
U.S. Ambassador/Bangladesh	1
Mission Director, USAID/Bangladesh	5
Assistant to the Administrator, Bureau for Asia and Near East (AA/ANE)	1
Office of South Asian Affairs (ANE/SA)	1
Audit Liaison Office (ANE/DP/F)	1
Bureau for External Affairs (AA/XA)	2
Office of Press Relations (XA/PR)	1
Office of Legislative Affairs (LEG)	1
Office of General Counsel (GC)	1
Assistant to the Administrator for Management (AA/M)	2
Assistant to the Administrator for Personnel & Financial Management (AA/PFM)	1
Directorate for Food and Agriculture (S&T/FA)	1
Office of Financial Management (PFM/FM/FP)	2
Center for Development Information and Evaluation (PPC/CDIE)	3
Inspector General	1
Deputy Inspector General	1
Office of Policy, Plans and Oversight (IG/PPO)	2
Office of Programs and Systems Audit (IG/PSA)	1
Office of Legal Counsel (IG/LC)	1
Office of Resource Management (IG/RM)	12
Assistant Inspector General for Investigations and Inspections (AIG/I)	1
Regional Inspector General for Investigations/Singapore (RIG/I/S)	1
RIG/A/Cairo	1
RIG/A/Dakar	1
RIG/A/Manila	1
RIG/A/Nairobi	1
RIG/A/Tegucigalpa	1
RIG/A/Washington	1