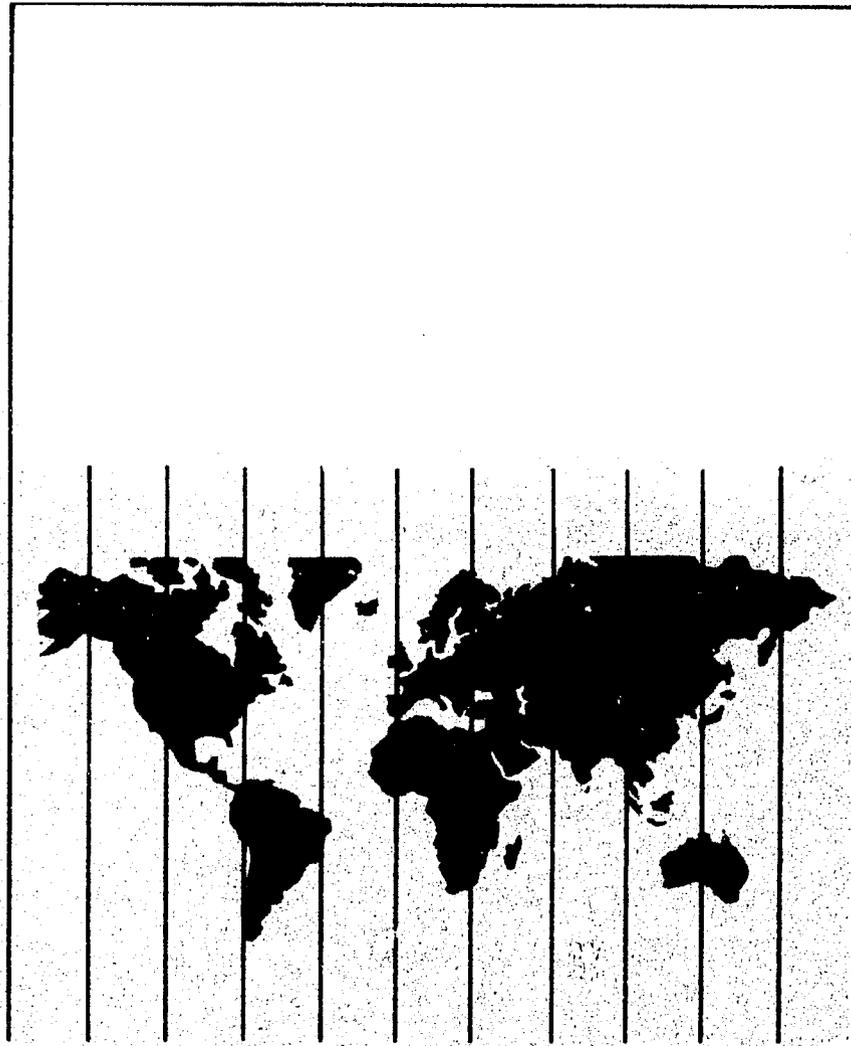


UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit

TEGUCIGALPA

PD-ABC-165
ISA 69389

**Audit of USAID/Honduras'
Rural Roads II
Project No. 522-0214**

Audit Report 1-522-91-002
November 20, 1990

AGENCY FOR INTERNATIONAL DEVELOPMENT

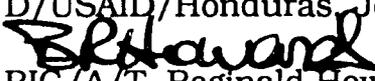
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AMERICAN EMBASSY
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November 20, 1990

MEMORANDUM

TO: D/USAID/Honduras, John Sanbrallo
FROM: 
RIG/A/T, Reginald Howard
SUBJECT: Audit of USAID/Honduras' Rural Roads II Project No. 522-0214

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of USAID/Honduras' Rural Roads II Project. Five copies of the final audit report are attached for your action.

The draft audit report was submitted to you for comment and your comments are attached to the report. The report contains four recommendations. All four recommendations are closed upon issuance of this report.

We appreciate the cooperation and assistance provided the auditors on this assignment.

Table of Contents

| | <u>Page</u> |
|-------------------------------------|-----------------|
| EXECUTIVE SUMMARY | i |
| INTRODUCTION | 1 |
| Background | 1 |
| Audit Objectives | 1 |
| REPORT OF AUDIT FINDINGS | 2 |
| Project Progress | 2 |
| Host Country Contracting Procedures | 4 |
| Host Country Contributions | 8 |
| Compliance and Internal Controls | 17 |
| | <u>Appendix</u> |
| SCOPE AND METHODOLOGY | I |
| MANAGEMENT COMMENTS | II |
| REPORT DISTRIBUTION | III |

EXECUTIVE SUMMARY

Started in July 1985, the Rural Roads II Project was designed to: (1) rehabilitate approximately 1,000 kilometers of rural roads, (2) maintain the rural road network of 3,000 kilometers, and (3) institutionalize the rural roads rehabilitation and maintenance capacity. A.I.D. authorized \$20 million life-of-project funding and the Government of Honduras agreed to provide the equivalent of \$14.9 million.

As of June 1990, the project completed its fifth year of implementation and was within six months of completion. Based on our review we concluded that:

- the objective to rehabilitate approximately 1,000 kilometers of rural access roads will likely be met,
- the rural roads rehabilitation capacity is being institutionalized within the Government of Honduras,
- the rural roads maintenance capacity within the Government of Honduras was not institutionalized during the life of the project,
- the Government of Honduras did not adequately address the workload capacity of individual road rehabilitation contractors during the prequalification process,
- the Government of Honduras did not fulfill its original commitment to fully fund a maintenance program,
- USAID/Honduras needs supplemental management and audit information to adequately monitor host country contributions.

The report contains four recommendations. USAID/Honduras concurred with these recommendations and has taken action to implement them.

Office of the Inspector General

Office of the Inspector General
November 20, 1990

INTRODUCTION

Background

For over twenty years, A.I.D.--in collaboration with the Government of Honduras (GOH) --has been making a substantial investment in Honduras' rural road system. This focus on building or upgrading roads was to increase agricultural production and to provide greater access to social benefits in the areas of health, education, nutrition, and housing. Approximately 3,000 kilometers of rural access roads and trails have been rehabilitated.

The Rural Roads II Project is fifth in a series of such road development projects. The project began on July 3, 1985, and was planned to end in four years. The project's purpose was to institutionalize the rural roads rehabilitation and maintenance capacity within the proper GOH entities. Total planned inputs were \$34.9 million. A.I.D. authorized \$20 million (\$18.7 million in loan funds and \$1.3 million in grant funds) and the GOH agreed to contribute the remaining \$14.9 million in equivalent local currency.

The Rural Roads II Project was designed so that the host country would provide two major project outputs: (1) rehabilitation of access roads and construction of new bridges and (2) maintenance of the total rural road network. To accomplish the first output, the GOH agreed to perform host country contracting for construction services. To accomplish the second, the GOH agreed to make host country contributions for road maintenance.

Audit Objectives

The Office of the Regional Inspector General for Audit/Tegucigalpa audited USAID/Honduras' Rural Roads II Project to answer the following audit objectives:

1. What is the progress of the project?
2. Were A.I.D.-financed host country contracts for construction services (a) in compliance with A.I.D. requirements and (b) properly monitored to ensure timely, efficient, and effective contractor performance?
3. Did the host country make effective contributions to the project on a timely basis, and did USAID/Honduras establish an adequate system to monitor, evaluate, and verify the contributions?

Appendix I contains a complete discussion of the scope and methodology of this audit.

REPORT OF AUDIT FINDINGS

Project Was Progressing Despite Delays

The Rural Roads II Project did not accomplish all of its objectives in a timely manner. As a consequence, USAID/Honduras amended the project assistance completion date three times, resulting in a cumulative eighteen month extension beyond the original date of June 30, 1989. USAID/Honduras made the extensions at the request of the GOH because two important project outputs--road rehabilitation and road maintenance--had not been accomplished as planned.

Road rehabilitation has been slow due to delays in the completion of construction contracts. Although most delays appear to have been caused primarily by adverse weather conditions, others appear to have been caused by the performance problems of a few construction contractors. Notwithstanding these delays, it appears that the project will attain its overall output goal of 1,000 kilometers of rural roads rehabilitation and construction of corresponding bridges. As of June 30, 1990, 969 kilometers of roads and six bridges were completed. And an additional 56 kilometers of roads was in process of completion.

Road maintenance--which is also a responsibility of the GOH under the project--has been inadequate. Consequently, the roads rehabilitated under Rural Roads II and predecessor projects have been deteriorating and, as a result, the substantial investment that A.I.D. has made in the rural roads system of Honduras is in jeopardy.

The GOH notified USAID/Honduras of the severity of the maintenance problem during the fourth year of the project when it stated that it was unable to budget sufficient funds to maintain the rural roads in good condition. The GOH also advised USAID/Honduras not to continue rehabilitating more roads and recommended a shift in project emphasis to maintenance. During the same time period, USAID/Honduras also received the results of a project evaluation. The evaluation's key points relevant to rural road rehabilitation and maintenance were:

- Although the design contained minor defects, the roads had been well constructed
- The largest problem was the lack of maintenance for the roads
- The GOH had not fulfilled its commitment of counterpart funding or of providing adequate rural road maintenance.

In June 1990, USAID/Honduras summarized the current status of the project's maintenance problem. It concluded that the roads constructed under Rural Roads II and previous projects have not been properly maintained by the GOH and indicated that USAID/Honduras and the new GOH administration were working on a follow-on project (Rural Roads III) to address the problem. The follow-on project will use private contractors to assist in maintaining the rural roads network. In the interim, USAID/Honduras plans to use remaining Rural Roads II funds to rehabilitate those road segments recently identified as being in "bad condition" and to maintain those identified as being in "fair condition".

In our opinion, the project has not yet achieved a major purpose--the institutionalization of a rural roads maintenance capacity within the proper GOH entity. We believe, however, that it has made progress towards achieving its other purpose--the institutionalization of a rural roads rehabilitation capacity within the proper GOH entity. We believe that, in addition to the causes identified by the GOH and USAID/Honduras, project progress was hampered by procedural deficiencies within the host country contracting and contributions processes. We address these deficiencies as well as corresponding recommendations to improve USAID/Honduras' procedures in subsequent sections of this report.

Host Country Contracting Procedures Were Generally Followed

A.I.D.-financed host country contracts were in compliance with A.I.D. requirements, and USAID/Honduras properly monitored these contracts to ensure overall effective contractor performance. However, our examination identified prequalification procedures which if modified would improve the efficiency and timeliness of the overall host country contracting process.

Host Country Prequalification Process Contained Inherent Weaknesses.

By means of prequalification the capacity of prospective contractors is predetermined, thereby avoiding the problems which can arise if a low bid must be rejected because of a lack of responsibility on part of the bidder. Although it conducted three contractor prequalifications during the project, the GOH did not consistently ascertain the workload capacity of the contractors. Also, the GOH neither verified the data submitted by the contractors in the prequalification questionnaires nor inspected their equipment. As a result, some contractors received contracts to rehabilitate roads in excess of their capacity to perform the required work.

Recommendation No. 1: We recommend that USAID/Honduras and the Government of Honduras as part of the Government of Honduras' prequalifying process develop procedures to:

- 1.1 consistently make a determination of the workload capacity of each road rehabilitation contractor.**
- 1.2 verify the data submitted by the contractors in their prequalification questionnaires and inspect the equipment of the contractors.**

A.I.D. Handbook 11 requires that after the contracting agency has established what construction services are required and the type of contract to be used, it will prequalify interested firms. The intent of this guidance is to ensure that a "responsible bidder", one who has the technical expertise, management capability, workload capacity, and financial resources to perform the work, is selected. These factors are to be evaluated and determined during the prequalification process.

The GOH conducted three prequalifications during the Rural Roads II project. One of the three prequalifications was conducted solely for bridge building contractors. During this prequalification the GOH made a workload capacity determination for each

contractor. The GOH clearly stated how many bridges each contractor could build based on its evaluation of the contractor's questionnaire data.

The other two prequalifications were for road rehabilitation contractors. Workload capacity was not consistently assessed for each of these contractors. As a part of these two prequalifications, the GOH assigned a numeric score for each contractor for each criteria. The GOH compared the total score of the criteria against a predetermined minimum total prequalifying score. At this point the GOH judged the contractor to either be qualified or not be qualified to participate in the bidding for A.I.D.- financed road rehabilitation projects. In one of these two prequalifications the GOH made no determination as to the workload capacity of each contractor but in the other the GOH divided the contractors into two groups. One group was given a workload limitation of one project; whereas, no workload limitation was made for the contractors in the other group. Accordingly, a workload capacity was not determined for the majority of the road rehabilitation contractors prequalified.

Moreover, the GOH prequalification committee **did not verify** the quantitative data submitted by the contractors or **inspect** the contractors' construction equipment. As a result, contractors received contracts in excess of their capacity to perform and one contractor **could not perform** two of the four contracts which it had received, thereby delaying the benefit that the rehabilitated roads would have provided to the local communities.

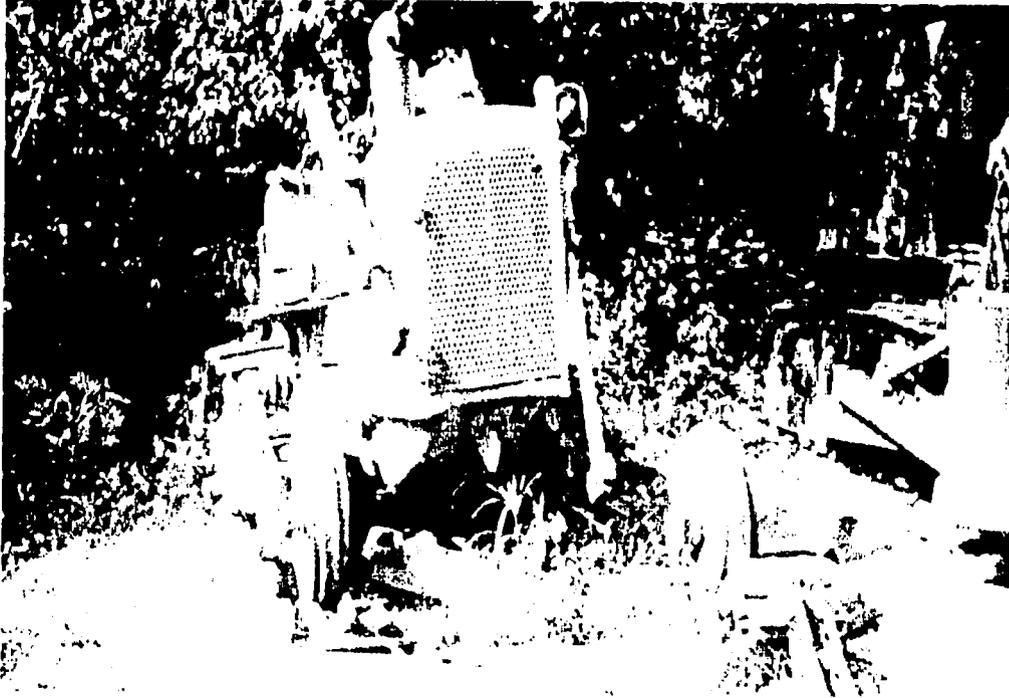
In other instances **road segments were delayed** because contractors did not have the needed capacity and/or proper equipment. One road rehabilitation contract illustrates those deficiencies. In this situation the contractor was permitted to receive a contract even though it was under capitalized and its construction equipment was insufficient and defective. During the contract period some of the equipment broke down or ran out of fuel and was abandoned by the side of the road being rehabilitated. Because of the contractor's poor performance, the road rehabilitation was not completed and was over eight months behind schedule as of June 30, 1990. The unfinished state of the road left it extremely vulnerable to erosion and contributed to the damage it sustained due to subsequent heavy rains. This road was especially important to the project because A.I.D. had invested more than \$480,000 in the construction of five bridges along this road segment. The bridge construction had been successfully completed by other contractors. But because the adjoining road was not complete benefits from the investment in the bridge construction have not been realized.

Management Comments

USAID/Honduras concurred with the audit finding and recommendation. It is working with the GOH to implement revised prequalification procedures for contractors under the follow-on project.

Office of Inspector General Comments

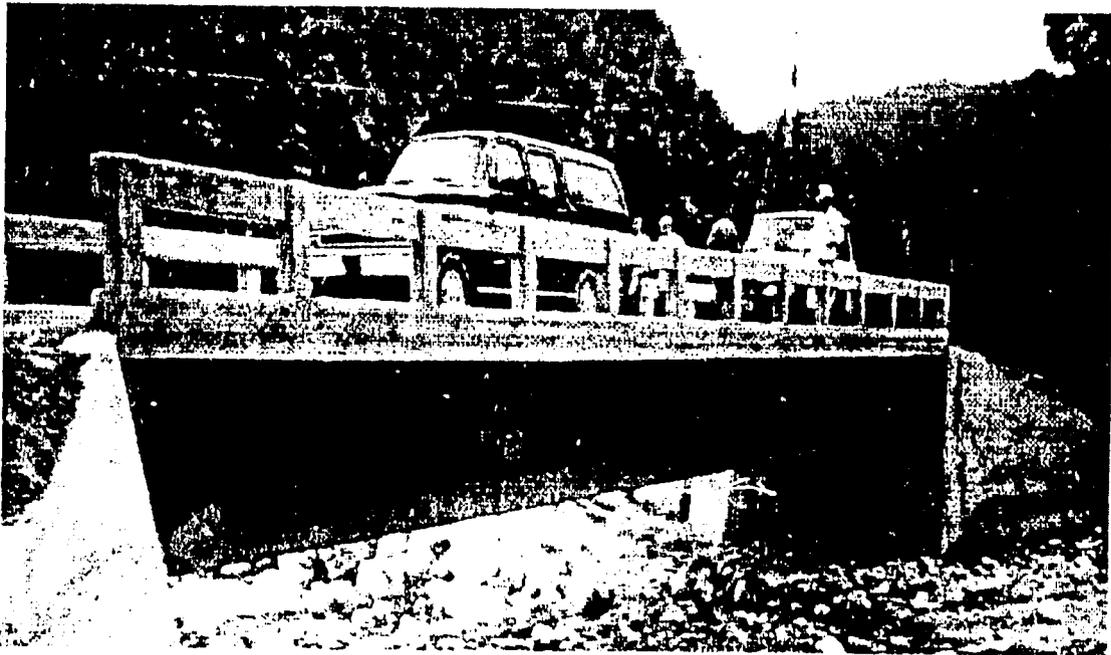
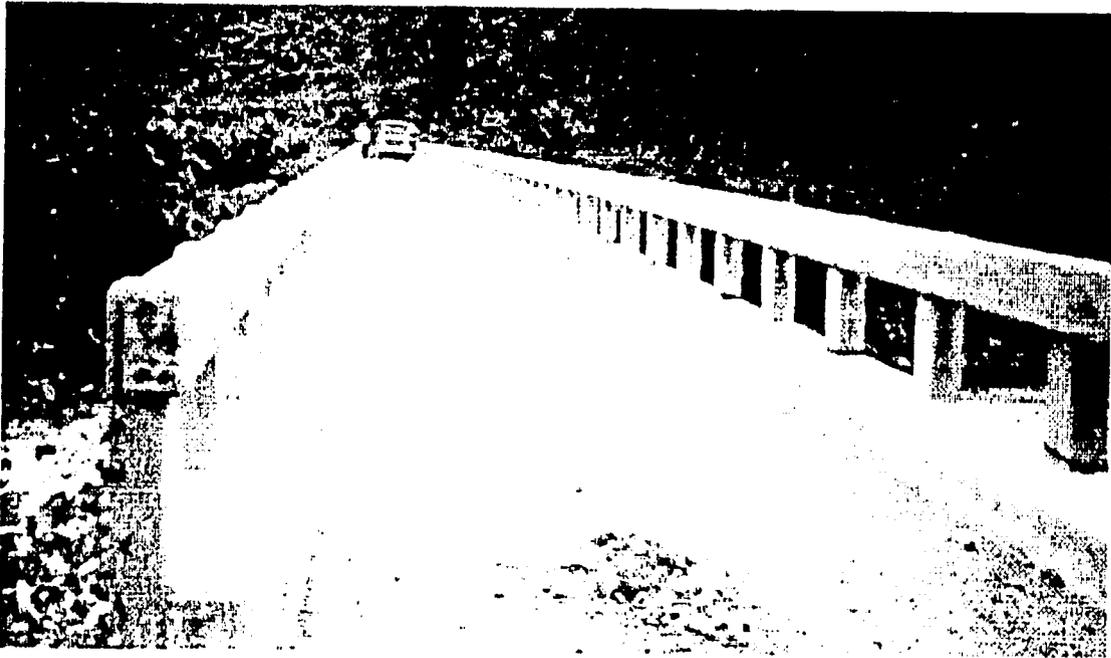
Audit recommendations 1.1 and 1.2 are closed upon issuance of this report.



Equipment stationed in various places along the unfinished segment was in disrepair or idle due to lack of fuel.

(La Ceiba - Yaruca Road Project,
July 9, 1990)

La Ceiba - Yaruca Road Project



Although A.I.D. had invested over \$480,000 in bridges along this road segment, it remains unfinished because a poorly qualified road rehabilitation contractor has been unable to complete its contract. The GOH has stated that it now plans to finish the road segment with its own construction equipment and will reduce the contract price accordingly.

USAID/Honduras Monitored Host Country Contributions, but the Contributions Could Have Been More Effective

The GOH was unable to fulfill its original commitment to fund 43 percent of the total project cost. Consequently, USAID/Honduras and the GOH reduced the commitment to 37 percent of total project cost. This reduction disproportionately diminished the effectiveness of the contribution because the amount used for road maintenance was reduced, while the amounts used for overhead costs were not reduced. Also, local maintenance laborers did not receive their salaries punctually which caused an inefficient use of host country contributions.

The GOH was unable to fulfill its original commitment to the project

The July 1985 Project Agreement established a GOH contribution equivalent to \$14.9 million--or 43 percent of total project cost. In October 1988, the GOH notified USAID/Honduras that it would be unable to provide the road maintenance program with its own resources. In July 1989, USAID/Honduras observed that the GOH had provided approximately 100 percent of project operating costs supporting the road rehabilitation program, but only approximately 48 percent of its commitment to the road maintenance program.

The GOH cited two primary causes for this shortfall: (1) the amount of contribution to which the previous GOH administration had committed was excessive; and (2) much of the contribution was contemplated to be "in-kind" (i.e. to be provided through regular GOH maintenance equipment and work force). The GOH subsequently acknowledged a shortage of such equipment, its inability to repair it, as well as chronic shortages in materials and supplies.

Because of the GOH request, USAID/Honduras reduced the GOH contribution to the project on August 1, 1989, to the equivalent of \$11.9 million--or 37 percent of the total project cost--and extended the project assistance completion date. As the chart on page 10 illustrates, this reduction diminished the amount allocated to the road maintenance program--a critical project output. In our view, the reduction also diminished the overall value of the GOH contribution to the project. This becomes apparent when the contribution is viewed in cost accounting components, i.e. direct vs. indirect. Although the direct costs contributed (maintenance) were significantly reduced, the total indirect costs contributed (operations, supervision, and administration) proportionately increased. This occurred because the indirect costs consist primarily of fixed allocations of salaries of GOH administrative personnel supporting the road rehabilitation and maintenance programs. For example, 25 percent of the salaries of GOH district chiefs are allocated to the project regardless of the level of direct maintenance effort. We believe that a

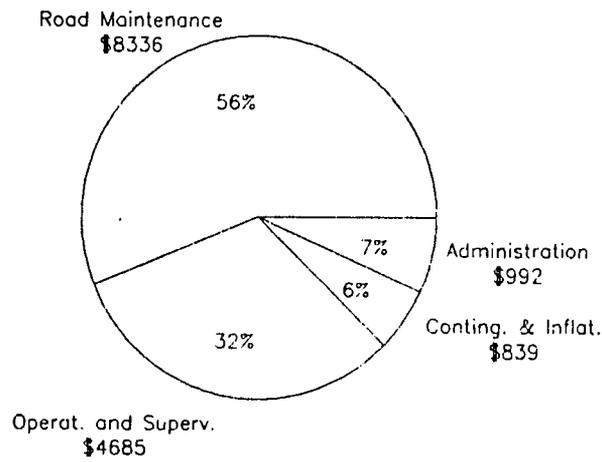
portion of these allocations could have been reduced commensurate with the reduction in direct costs.

Disregarding the disproportionate manner the reduction was applied, as of June 30, 1990, the GOH appeared to be fulfilling its reduced contribution commitment. The project life was 91 percent complete and, according to GOH statements, it had contributed the equivalent of \$10.4 million or 88 percent of the agreed to \$11.9 million. (See chart on page 11.)

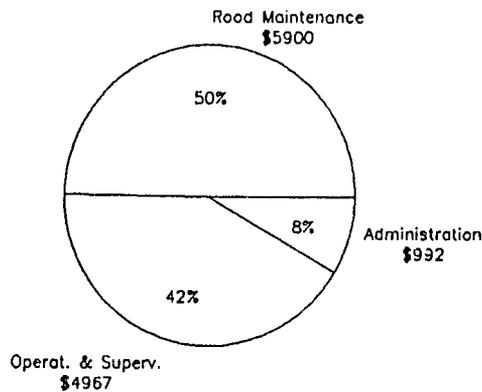
THE GOVERNMENT OF HONDURAS CONTRIBUTION

Overhead Costs Were Not Reduced
Commensurate With Maintenance Costs
(000's)

Original Budget
\$14,852



Revised Budget
\$11,859

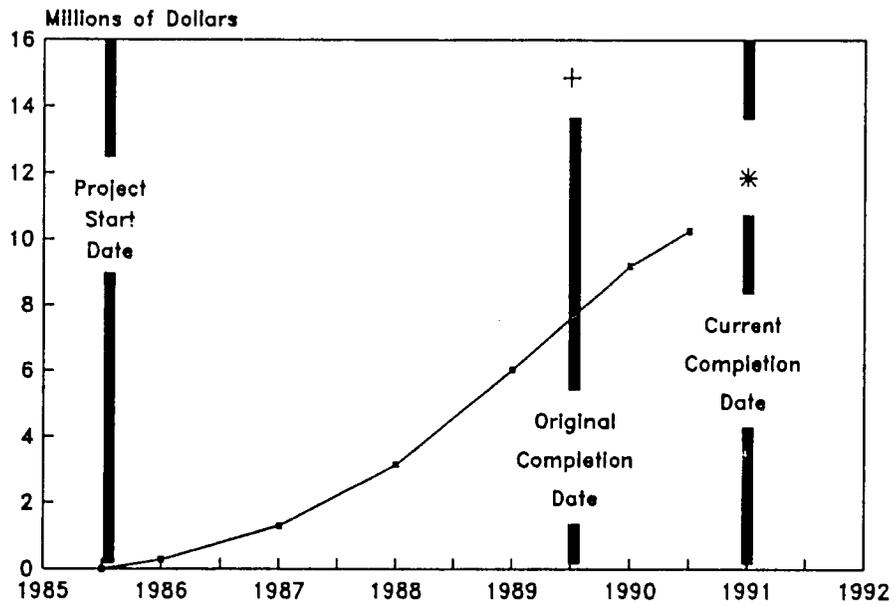


Source: Project Agreement, A.I.D. Project No. 522-0214 and Project Agreement Amendment No. 5.

**THE GOH HAS BEEN UNABLE TO MAKE CONTRIBUTIONS
AS IT ORIGINALLY AGREED**

**Original Budget, Revised Budget,
and Actual Contributions**

From July 1985 through June 1990



Legend: + Original Target of \$14.852 million by June 30, 1989
 * Revised Target of \$11.859 million by December 31, 1990
 -.- Actual Contributions of \$10.391 million thru June 30, 1990

Source: Budget target figures are from A.I.D. Project Agreement No. 522-0214 and Project Agreement Amendment No. 5. Actual contribution figures are from unaudited statements by the Government of Honduras.

Administrative practices created inefficiencies in the use of host country contributions

An important component of the GOH contribution is the road maintenance program carried out by local laborers. We identified two GOH administrative practices pertinent to paycheck delivery which were ineffective and adversely affected the morale of the laborers. By changing these practices, the GOH will be able to increase the efficiency of this program.

Recommendation No. 2: We recommend that USAID/Honduras work with the Government of Honduras to develop procedures to pay local laborers on a timely and efficient basis.

According to the Project Agreement, local maintenance is to be contracted with members of the community on a minimum wage salary basis. To accomplish this, the GOH initiated a road crew¹ concept of rural road maintenance. Both the GOH and USAID/Honduras have concluded that this concept--when applied in conjunction with periodic heavy equipment usage--is highly effective.

At the inception of the project and in response to concerns by both USAID/Honduras and the GOH that the road crews be paid punctually for their efforts, a special covenant to the Project Agreement was established stating that the Borrower/Grantee will establish a mechanism so that maintenance personnel will receive their salaries punctually.

We interviewed supervisors and road crews working within four of the eleven GOH district areas. All persons interviewed complained of two administrative practices pertaining to paychecks which were inefficient and adversely affected the morale of the workers.

The first practice involved the timeliness of payment. Although most of the road crews had been under contract since February 1990, they had not been paid for their first two months of effort until July 1990. Our later interviews with GOH officials confirmed that the road crews were usually not paid on time and paychecks have been issued, on average, over one month late. These officials cited reasons for this late issuance of paychecks: (1) the quarterly apportionment of budgetary funds amongst the GOH entities is an inherently slow process, especially when there has been a concurrent change in the GOH administration and (2) it is a cumbersome process for the GOH to generate a payroll, which must ultimately be approved each month by a GOH minister.

¹ The road crews, called peones camineros, performed routine maintenance such as: cleaning the road ditches, filling holes and low places in the roads, cleaning culverts and drains, cutting weeds and growth along shoulders and in ditches, removing small landslides, and smoothing the road surfaces. Each member of a road crew was assigned a section of road to maintain near his home.

The second practice involved the method of payment. The road crews were required to travel long distances during working hours in order to obtain their paychecks. They stated that they had to obtain their salary at the district offices after hearing an announcement on the local radio station. But each road crew had to travel--at his own expense--to a district office to obtain the paycheck. Typically it took one work day to accomplish this. The road crews were paid by the GOH for that day but were not reimbursed for transportation cost (usually bus fare, which was 50 percent to 75 percent of a day's pay). On a national level, the future monetary impact of this lost work time will be the equivalent of approximately \$87,000 during the life of the follow-on (Rural Roads III) project.²

By amending its administrative practices regarding the timeliness and methodology for payment, the GOH can improve morale and efficiency in the road crew program. Paying the workers on time will encourage their support for the program. Providing them their payments closer to their daily work sites could permit a more efficient use of GOH funds, as it may enable them to perform some road maintenance on payday rather than losing the entire day traveling to district offices to obtain paychecks. Payment alternatives could include the GOH transferring salary funds to local banks near the road crews' work sites or providing a cash payment delivery system to the work sites.

Management Comments

USAID/Honduras generally concurred with the audit finding and recommendation. It reported that the GOH is gradually making changes to its cumbersome and inefficient payment procedures. USAID/Honduras stated that it will continue working with GOH officials to find different alternatives to solve the salary payment problems.

Office of Inspector General Comments

Based on USAID/Honduras actions, Recommendation 2 is closed upon issuance of this report.

²Computed as follows:

| | |
|-----------------|---------------------|
| 600 | road crew workers |
| <u>X8</u> | lempiras per day |
| 4,800 | lempiras per month |
| <u>X12</u> | months |
| 57,600 | lempiras per year |
| <u>/4.31</u> | lempiras per dollar |
| 13,411 | dollars per year |
| <u>x6.5</u> | years |
| <u>\$87,171</u> | |
| <u>\$87,000</u> | (Rounded) |



The rural road crew maintenance program has been adversely affected by ineffective salary payment practices by the Government of Honduras.

USAID/Honduras did not require sufficient management information

The statements of contribution activity submitted by the GOH did not provide sufficient visibility into the composition of the contributions to the project and were not timely. As a result, USAID/Honduras did not have sufficient management information to promptly alert it to late or insufficient contributions.

Recommendation No. 3: We recommend that USAID/Honduras require the Government of Honduras to submit quarterly contribution statements containing supplemental management information.

An important component of the host country contribution on this project is the funding for road maintenance. USAID/Honduras has recognized the need to assure that the GOH contributes to this component. In November 1988, USAID/Honduras noted in summary comments to the project evaluation:

It is difficult to assure GOH compliance to its commitment for provision of counterpart funds, especially for road maintenance. Consequently, A.I.D. should investigate methods to assure provision of an adequate level of maintenance for rural roads other than a written commitment by GOH.

USAID/Honduras did not have management information to promptly alert it to late or insufficient contributions and the GOH submitted statements which did not contain a sufficient level of detail. During the early years of the project, statements were submitted once per year. During the past year, they have been submitted semiannually. Data was presented in general categories (e.g. cash vs. "in kind" or maintenance, administration, etc.) which did not permit sufficient visibility into the composition of the contribution. USAID/Honduras personnel acknowledged that their monitoring could be improved if additional management information was submitted on a regular basis. They noted, however, that the present system--which relies heavily upon site visits, financial reports from the GOH finance ministry, and continual interactions with GOH officials as monitoring methods--has been generally effective during the project. For example, they noted that the system alerted USAID/Honduras management to the potential shortfall in the contribution in 1989. As a result, USAID/Honduras soon amended the Project Agreement to reduce the total contribution to a more realistic level.

We observed that the GOH implementing entity accumulated useful source data pertinent to maintenance activity at its field operations (district) level. This data included the number of work days performed by road crews, the number of hours that heavy equipment was used on the roads, and the quantity of raw materials used. But after the GOH had summarized this information and combined it with other data for its statement

to USAID/Honduras, the visibility into field operations was lost. The GOH contribution was only presented in general monetary categories to USAID/Honduras.

In order to optimize its monitoring process, USAID/Honduras needs to have comprehensive management information on a more frequent basis. By requiring the GOH to submit quarterly statements with such information, it will have a better means of assuring an adequate level of road maintenance. Statements containing comprehensive management information could be used by USAID/Honduras to promptly identify trends, problem areas or systemic weaknesses in the contribution activity. For example, insufficient use of road crews, excessive administrative costs, and heavy equipment inactivity could be promptly detected if such information were included in a quarterly statement of contributions.

Management Comments

USAID/Honduras concurred with this audit finding and recommendation. It will require the GOH to submit quarterly statements of host country contributions containing supplementary management information.

Office of Inspector General Comments

Based on USAID/Honduras actions, Recommendation 3 is closed upon issuance of this report.

Independent financial audits needed to be performed

When responsibility for project funding is shared with a host country, there is a joint accountability for that project's success. Independent financial audits are an efficient method of strengthening such accountability as well as reducing vulnerability to fraud, waste, and abuse. USAID/Honduras did not ensure that independent financial audits were performed of the host country contribution. As a consequence, such audits were not performed and there was no assurance that the amount compiled and submitted by the GOH was accurate or proper.

Recommendation No. 4: We recommend that USAID/Honduras ensure that an audit of the host country contribution is performed.

A.I.D. issued Payment Verification Policy Implementation Guidance to all Missions in December 1983. It required project papers to include an evaluation of the need for audit coverage in light of potential audit risks and to describe planned project audit coverage by the host government and/or independent public accountants. Project funds should be budgeted for independent audits unless adequate audit coverage is reasonably assured or audits by third parties are not warranted. The Rural Roads II Project paper, which was approved in July 1985, did not describe planned audit coverage on the project.

Consequently, financial audits of project components--including the host country contribution--had not been performed by the GOH audit activity (Controller General) nor an independent accounting firm. Consequently, assurance that the contribution was accurate or proper was lacking.

Management Comments

USAID/Honduras included a provision for audits in the follow-on project. It also advised that the audit activity of the GOH was in the process of contracting an audit of the Rural Roads II Project host country contribution.

Office of Inspector General Comments

Based on USAID/Honduras actions, Recommendation 4 is closed upon issuance of this report.

Compliance and Internal Controls

Compliance

We limited the review to the issues in this report. Nothing came to our attention that would indicate that USAID/Honduras did not comply with applicable laws and regulations.

Internal Control

The review of internal control was limited to the issues discussed in this report. We noted one reportable internal control problem.

Audit Objective No. 3 - The Mission did not ensure that an independent financial audit of the host country contribution was performed.

Nothing else came to our attention that would indicate that areas not reviewed suffered from inadequate controls.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Honduras' Rural Roads II Project in accordance with generally accepted government auditing standards. We conducted the audit from April 2 through July 31, 1990, and covered the systems and procedures relating to host country contracting for construction services and host country contributions from July 3, 1985, (project inception) through June 30, 1990. As noted below, we conducted our field work in the offices of USAID/Honduras, at the headquarters and district offices of the GOH implementing entity, Secretaria de Comunicaciones, Obras Publicas y Transporte (SECOPT), and at various rural road sites throughout Honduras.

Methodology

Audit Objective One

The first audit objective consisted of obtaining information to determine the status of the project. To accomplish this objective, we:

- Relied primarily upon a 1988 evaluation report, a 1989 USAID/Honduras financial review report, and 1990 field survey reports conducted by USAID/Honduras.
- Physically observed portions of the 1990 field surveys conducted by USAID/Honduras.
- Through discussions with responsible officials obtained an update on the project's status.

Audit Objective Two

To accomplish the second audit objective of verifying compliance with and monitoring of construction services contracts, we:

- Determined whether (1) allowable forms of contracts were selected, (2) proper competitive procedures were followed in choosing contractors, (3) contracts provided reasonable assurances that the necessary services would be provided on time and at a fair price, (4) contracts were expeditiously awarded, (5) contractors were performing according to contract terms, and (6) contracting and performance data were obtained, maintained, and fairly disclosed in reports.
- Examined the project paper's procurement plan, the project agreement, project implementation letters, advertisements, lists of prequalified offerors, contracts, A.I.D. approvals, site visit reports, progress reports, and contract monitoring files.

- Held discussions with officials at SECOPT and the Mission.
- Physically inspected road sites which were in the process of being rehabilitated by contractors.

Audit Objective Three

To accomplish the third audit objective of determining if the host country made effective contributions to the project on a timely basis and if USAID/Honduras established an adequate system of monitoring host country contributions, we:

- Determined whether the GOH initially provided satisfactory assurance that it would contribute to the costs of the project.
- Examined critical assumptions included as covenants to the Project Agreement, and concluded whether the GOH made timely and effective contributions to the project.
- Held discussions with road crews, SECOPT personnel in district and headquarters offices, and mission officials.
- Determined the purpose of the host country contribution for the project.
- Obtained the views of mission personnel about the effectiveness of the current host country contribution monitoring system.
- Determined the extent and scope of audits of the contributions.
- Examined the project paper, Project Agreement, project implementation letters, statements of contribution, and evaluations and reviews.
- Traced host country contribution problems identified during the audit to the monitoring system to see if they were identified and acted upon in a timely manner.

MEMORANDUM

To: Reginald Howard, RIG/A/T

Date: October 31, 1990

FROM: John Sanbrailo, Mission Director, USAID/Honduras

Subject: Draft Audit Report on USAID/Honduras's Rural Roads II (RR II) Project No. 522-0214

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We would like to thank the Office of the Regional Inspector General for Audit, Tegucigalpa for the detailed work and effort that went into this audit. The audit is a useful tool to make some systemic changes to the way we carry out our other projects. The members of your audit team were very professional and our staff enjoyed working with them. Your staff impressed us with the professional way they conducted formal audit briefings with our staff. They also were very good about keeping the USAID Audit Liaison Officer up to date so he could brief management.

Our only comment about the Executive Summary is that we disagree with the wording on page i.i. It states "the rural roads maintenance capacity within the Government is not being institutionalized." We believe that as a result of lessons learned in this project that the GOH has decided to privatize the maintenance of rural roads. The new Rural Roads III project will promote this concept and make it a success over the life of the project. Therefore, we request that you change this statement in the final report. In fact we believe that the USAID and the GOH should receive a positive statement on this point of having the GOH institutionalize rural road maintenance.

The Mission response to the specific audit recommendations is as follows.

Audit Recommendation No. 1: We recommend that USAID/Honduras and the Government of Honduras as part of the Government of Honduras' prequalifying process develop procedures to:

1.1 consistently make a determination of the work capacity of each road rehabilitation contractor.

1.2 verify the data submitted by the contractors in their prequalification questionnaires and inspect the equipment of the contractors.

Mission Response:

A new pre-qualification of construction companies is in process by SECOPT. SECOPT has created a new set of forms and procedures designed to address the problems described in the audit report, including the issue of data verification and equipment inspection. The USAID is in the process of approving the new forms and procedures. The new forms will be used for all Rural Roads III contracts.

SECOPT will pre-qualify three classes of companies. Companies able to: 1) Perform road rehabilitation or construction, 2) Perform heavy maintenance or 3) Perform light, routine maintenance. This procedure will allow contract awarding to companies according with their real work capacity. The GOH will take steps to verify the data presentation by contractors including on-site inspections of equipment as necessary. Also, as stated in Rural Roads Maintenance Project, RRMP, (522-0334) Project Paper, SECOPT will update the pre-qualifications at least once a year. The update will consider contractor performance in previous contracts. It will also incorporate new firms and upgrade or downgrade the capacity level of existing firms. SECOPT will make rating changes for existing contractors based on performance and changes in capacity. (Rural Roads III, Project Paper - Technical Analysis C.3. page 62).

USAID/Honduras personnel participated in the preparation of the these new documents and specifically approved the use of them by SECOPT. Also, an A.I.D. engineer will participate in meetings with a Committee formed by SECOPT to rate the companies. A.I.D. will specifically approve the final list of pre-qualified companies as well as the invitation to participate in project packages bidding.

We have attached copies of the new pre-qualification forms to this memorandum. Also included is a copy of the Evaluation Methodology.

Based on the above, we request that you close this recommendation upon issuance of the final audit report.

Audit Recommendation No. 2: We recommend that USAID/Honduras work with the Government of Honduras to develop procedures to pay local laborers on a timely and efficient basis.

Mission Response:

SECOPT's General Directorate of Roads and Airports Maintenance, GDRAM, is making gradual changes of the cumbersome and inefficient payment procedures. SECOPT can only make changes within its own area of influence. However, it is important to note that other GOH entities control payment procedures and funds allocation to SECOPT. These agencies include the Ministry of Finance and the General Treasurer of the Republic.

21-

The new Rural Roads III ,Project No. 522-0334, includes a study to address this problem. SECOPT and the USAID are investigating the use of trust funds or rotating funds managed at the District level to solve late salary payment to workers. (Project Agreement, Section 2.a). The Mission will continue working with SECOPT and the Ministry of Finance, to find different alternatives to solve this problem. A sudden change on this issue is not predictable since it implies the participation of various GOH agencies. The changing of long established managerial procedures or the implementation of new payment procedures across several agencies is a very difficult task.

The present system does have one good feature. It is not easily susceptible to fraud. For this reason, we must be very careful not to weaken the current good internal control features as we attempt to improve the timeliness of the payments. We need to understand and appreciate that late payment of government workers is an endemic problem to third world countries.

Based on our efforts to ameliorate the present situation we request that you close this recommendation upon issuance of the final audit report. You could then schedule a follow up review some time in the future to see what progress we made.

Audit Recommendation No. 3: We recommend that USAID/Honduras require the Government of Honduras to submit quarterly contribution statements containing supplemental management information.

Mission Response:

In Annex 4, of PIL No. 1 (attached) you will find the forms designed to address the reporting problem on the lack of on-time information on contribution statements. In the future, the GOH will prepare a quarterly report for its counterpart contributions. USAID/Honduras will then have up to date information about different parts of project counterpart contributions.

In addition, the USAID has adopted this concept for all of its future projects. We will adjust the reporting on existing projects at appropriate times during their implementation.

Based on the actions taken we request that you close this recommendation upon issuance of the final audit report.

Audit Recommendation No. 4: We recommend that USAID/Honduras ensure that an audit of the host country contribution be performed.

Mission Response:

The new Rural Roads Maintenance Project (522-0334), has provision for the performance of three Evaluations and Audits. The Project Agreement has a specific budget line item with funding to perform such evaluations and audits in years 3, 4 and 6 of the life of the project.

22

The Controller General of Honduras is the process of performing an audit of the GOH contributions to the Rural Roads II project. (Letter Attached)

Based on the above we request that you close this recommendation upon issuance of the final audit report.

~~MBH~~
Drafter: MBHorween, CONT
Clearance: RAdams, ENG: RDH *ch*
GWachtenheim, DMD:
MWilliams, RLA: MAW
LKlassen, DF: KL
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MBH:maf

23-

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24-