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AUDIT OF USAID/JAMAICA
AGRICULTURAL DEVELOPMENT FOUNDATION
PROJECT NO. 532-0105

Audit Report No. 1-532-86-22
July 11, 1986

AGENCY FOR INTERNATIONAL DEVELOPMENT

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July 11, 1986

MEMORANDUM

TO : D/USAID/Jamaica, William Joslin

Coinage N. Gothard

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

SUBJECT: Audit of Jamaica Agricultural Development Foundation, Project No. 532-0105

This report presents the results of audit of the Jamaica Agricultural Development Project. A program results audit was made to determine whether the project was achieving its intended results, to evaluate the adequacy of internal controls and assess compliance with AID procedures.

The audit showed that after two years of implementation the project did not appear to be fully achieving its intended goals of establishing a self-sustaining Foundation with a sound resource base available to all agricultural subsectors. In addition, the project lacked adequate internal controls and did not fully comply with AID requirements.

The project was hampered by commodity processing and marketing problems, by deficiencies in project operations, by non-compliance with certain terms in the project agreements, and by inadequate controls over commodities. The audit also revealed shortcomings in USAID/Jamaica's internal controls.

The Jamaica Agricultural Development Foundation project was functioning at less than full capacity primarily because of reduced commodity sales revenues. This situation has caused USAID/Jamaica to support the Foundation with substantial grants which were not anticipated at the project's outset.

The Foundation's lending and investment practices were not always in accordance with the project's original intent and purpose, resulting in limited financial assistance being provided to those agriculture sectors targeted for assistance (mainly small farmers and the dairy industry).

The amount of business activity that the Foundation conducts with companies which are linked to the Foundation, either by having employees on the Foundation's Board of Directors or in some other way, raises concerns over the potential for "self-dealing" and conflict of interest.

USAID/Jamaica did not require the Foundation to reimburse funds to AID in accordance with a project grant agreement which was carelessly approved and amended.

USAID/Jamaica had not adequately monitored the use of project resources. As a result, some project funds were not being used for agriculture development but, instead, to pay questionable Foundation operating expenses.

Project butter inventory levels were greater than could be effectively used in the foreseeable future. Continued storage costs and the possibility of commodity losses through deterioration required that action be taken to reduce current butter inventory levels.

The report makes recommendations to either obtain additional funding sources or to adjust the project's objectives and operations in line with reduced commodity revenues, adjust the Foundation's investment/lending policy to ensure that project revenues will be used to strictly finance agriculture activities and ensures preferential treatment will be given to small farmers and dairy industry activities, amend the Foundation's articles of association to better protect against "self-dealing" and conflict of interest, require reimbursement of grant funds, improve USAID/Jamaica monitoring of operational expenses, eliminate unnecessary operational expenses and deobligate excess funding, and reduce existing butter inventories.

We discussed our findings and recommendations at an exit conference with you and cognizant members of your staff, and we submitted a draft report for your review and comment. Your comments and suggestions were, for the most part, included in the final report.

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

EXECUTIVE SUMMARY

The Jamaica Agricultural Development Foundation Project was a unique private sector project financed primarily from donated U.S. PL 480 Title II commodity sale revenues. It was proposed in September 1983, by Land O'Lakes, Inc., a dairy cooperative of the United States, and Grace, Kennedy & Co. Ltd., a Jamaican food conglomerate and was approved by AID in 1984. The project's purpose was to create a sound, self-sustaining, non-profit foundation to manage a new and urgently needed private sector resource base for financing Jamaican agricultural development activities. Under the project, AID grants approximately 4,000 metric tons of surplus bulk cheese and butter to the Foundation each year for six years. The value of these commodities for the first year was about $5 million. The sale revenues from these commodities was used for JADF operating expenses and to finance loans, grants and equity investments to help promote the growth of Jamaica's agriculture sector. AID also approved three grants for about $1.6 million for the project.

A program results audit was made to determine whether the project would achieve its intended results, to evaluate the adequacy of internal controls and assess compliance with AID procedures. The audit covered $7.5 million in AID grant funds and PL-480 Title II commodity donations and included project activities from early 1983 through March 27, 1986.

The audit showed that, after two years of implementation, the project was not fully achieving its intended goals of establishing a self-sustaining development Foundation with a sound resource base available to all agricultural subsectors. The project was hampered by commodity processing and marketing problems and deficiencies in project operations. In addition, the project was not in compliance with grant and project agreements.

USAID/Jamaica officials have spent an inordinate amount of their time in recent months addressing project problems caused, in part, by poor initial project development and management. While many problems have been resolved, considerable corrective actions were still needed, including: either increasing commodity revenues or adjusting program objectives and operations commensurate with reduced commodity revenues; making adjustments in the Foundation's investment policy to ensure compliance with the program's intent; mitigating the potential for, or at least the appearance of, "self-dealing" and conflict of interest; recovering reimbursable grant funds; making the foundation more cost effective; and resolving the remaining commodity problems.

The Jamaica Agricultural Development Foundation Project was functioning at less than full capacity primarily because of commodity processing and marketing problems which have reduced the project's revenues and caused a suspension in the project's lending activities. USAID/Jamaica and the Foundation have effectively dealt with some of these problems but the Foundation's situation remains precarious because of the project's heavy reliance on the sales proceeds of commodities which have only limited market demand in Jamaica. As a result, it was questionable whether the project's planned objectives could be fully achieved unless additional sources of commodity revenues were developed. If they are not, then the project's objectives and operations should be adjusted to reflect current revenue levels. We recommend that either additional funding sources be obtained or that the project's objectives and operations be adjusted in accordance with reduced commodity sale revenues. The Mission generally agreed.

Jamaica Agricultural Development Foundation lending and investment decisions have not always been made in accordance with the original intent and purpose of this project's authorization. This condition existed because USAID/Jamaica and the Foundation had not adequately addressed and translated the program's original investment goals, objectives and concerns into a clear and detailed investment policy to ensure that only agriculture activities receive financial assistance and that the small farmer and dairy industry activities receive preferential treatment. We recommend that an investment/lending policy and guidelines be developed to better ensure that program resources are used in accordance with the program's original intent and purposes. The Mission did not agree that additional guidelines were needed.

The Jamaica Agricultural Development Foundation was influenced by representatives from those Jamaican and American companies who were involved in the Foundation's development and who remain actively involved in its operations. These relationships were beneficial to the Foundation, especially during its early development stages. However, these relationships also benefited the companies with representatives on the Foundation's Board. This potentially serious conflict of interest situation occurred because the Foundation's Articles of Association do not adequately preclude Board members or their employers from directly benefiting from Foundation operations and investments. If this situation is not corrected, the Foundation could be abused and become subject to serious criticism affecting its credibility and overall effectiveness. We recommend that the Foundation's articles of association be amended to better ensure against conflicts of interest situations. The Mission agreed, but suggested that the recommendation be worded differently.

As of March 27, 1986, USAID/Jamaica had not required the Foundation to repay a $500,000 reimbursable grant which, according to the grant agreement, was to be repaid on September 30, 1985, following USAID/Jamaica's written instructions as to the form and means of repayment. In addition, USAID/Jamaica violated AID policy (AID Handbook 3, Chapter 6) and a Government of Jamaica agreement when it amended the grant agreement on November 8, 1984 because (1) repayment terms were modified in such a manner that the grantee could possibly pay back less than the equivalent of $500,000, and (2) USAID/Jamaica did not obtain the Government of Jamaica's approval as required under the grant's funding source project agreement. As a result, the United States Government has incurred interest costs of about $16,000 during the six-month period that AID funds have remained unrecovered and unavailable for other projects. We recommend that all disbursed grant funds be recovered. The Mission agreed and had initiated actions to recover the funds.

Office of the Inspector General

AUDIT OF USAID/JAMAICA AGRICULTURAL DEVELOPMENT FOUNDATION PROJECT

TABLE OF CONTENTS

AUDIT OF USAID/JAMAICA
AGRICULTURAL DEVELOPMENT FOUNDATION PROJECT

PART I - INTRODUCTION

A. Background

In the early 1980s, the Reagan Administration expressed the need for the international community to begin identifying ways in which private sector initiatives in and by developing countries could be fostered to increase the resource base and momentum of development. In response to this challenge, AID examined its policies and programs in an effort to more actively participate in private sector activities. In September 1983, Land O'Lakes, Inc., a dairy cooperative of the United States, and Grace, Kennedy & Co. Ltd., a Jamaican food conglomerate presented AID with a private sector project proposal to use surplus U.S. commodities to promote agricultural development in Jamaica. This proposal, known as the Jamaica Agricultural Development Foundation (JADF) Project, was approved by AID in 1984.

The Jamaica Agricultural Development Foundation (AID project number 532-0105) is a new type of AID development activity because it has been primarily financed through the sale of donated U.S. surplus dairy commodities. Its purpose was to create a sound, self-sustaining, non-profit foundation to manage a new and urgently needed private sector resource base for financing Jamaican agricultural development activities.

JADF was established in January 1984 as a private non-profit voluntary organization. Under the project, AID grants approximately 4,000 metric tons of surplus bulk cheese and butter to the Foundation each year for six years. The value of these commodities for the first year was about $5.0 million. Initially, the Foundation contracted with a local food processor to process the bulk commodities into retail consumer products, who then sold them to food distributors. This contract expired, and JADF now sells the bulk commodities directly to the food processors and to any other buyers who can be found or developed. As of December 31, 1985, the Foundation received 2,000 metric tons of butter and 2,688 metric tons of cheese valued at about $6.0 million. The net revenue generated from the sale of these commodities was used for JADF operating expenses and to finance loans, grants and equity investments to help promote the growth of Jamaica's agriculture sector. In addition, AID approved three separate grants for about $1.6 million for the project. These funds were primarily used to help establish the Foundation, to provide it with interim financing until commodity sale revenues were generated, and to fund various technical assistance activities.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa selected the Jamaica Agricultural Development Foundation Project for a program results audit because of its unique project financing concept and its private sector focus. It was reviewed during the period January 1986 through March 1986. The audit covered activities from early 1983 through March 27, 1986, and included a review of a total of $7.5 million in AID grant funds ($1.6 million) and PL-480 Title II commodity donations ($5.9 million).

The audit objectives were to:

-- determine whether the project was achieving its intended results;

-- evaluate the adequacy of internal controls, and

-- assess compliance with AID requirements.

To accomplish these objectives, we reviewed USAID/Jamaica project files and interviewed responsible AID officials in Jamaica and in Washington D.C. We also reviewed JADF project office files and interviewed Foundation officials, including one of its present and two former Board Directors, and one official of the food processor contracted with to process the PL-480 Title II commodities. In addition, we visited four Foundation loan recipients and queried them about their experience with the Foundation and about their need for and use of project funds. We also contacted two individuals who had their loan request disapproved by the Foundation. The audit was made in accordance with generally accepted government auditing standards

AUDIT OF USAID/JAMAICA
AGRICULTURAL DEVELOPMENT FOUNDATION PROJECT

PART II - RESULTS OF AUDIT

The audit showed that after two years of implementation the project did not appear to be fully achieving its intended goals of establishing a self-sustaining Foundation with a sound resource base available to all agricultural subsectors. In addition, the project lacked adequate internal controls and did not fully comply with AID requirements.

Nevertheless, the project has resulted in establishing a new Jamaica lending organization which has approved about $2.2 million in loans, equity investment, and grants in Jamaica's agriculture sector. As a result, new agriculture activities have been created and existing enterprises have been able to expand, thereby creating new employment opportunities and increasing Jamaica's agriculture exports.

The project was hampered by commodity processing and marketing problems, by deficiencies in project operations, by non-compliance with certain terms in the project agreements, and by inadequate controls over commodities. Some internal control problems were also noted at USAID/Jamaica. Many of the project's problems are attributable to previous Mission management officials who did not always follow standard operating procedures, were apparently not well qualified or trained in project design, planning and management, and did not establish adequate accountability controls.

USAID/Jamaica officials, in recent months, have spent an inordinate amount of time addressing the project's commodity related problems which, by the end of our audit, had partially been resolved. However, management still needs to (1) take actions to correct weaknesses and deficiencies in project operations, (2) ensure better compliance with grant and project agreements, and (3) reduce the project's large butter inventory levels. We recommend that the Mission in consultation with JADF, find ways of increasing commodity revenues or adjust the project's objectives and operations commensurate with less than expected commodity revenues, make adjustments in the Foundation's investment policy to ensure compliance with the program's intent, mitigate the potential for, or at least the appearance of, "self-dealing" and conflict of interest, recover reimbursable grant funds, make the Foundation's operations more cost effective, and resolve the remaining commodity problems.

A. Findings and Recommendations

1. Implementation Hindered by Reduced Commodity Sales

The Jamaica Agricultural Development Foundation Project was functioning at less than full capacity primarily because of commodity processing and marketing problems which have reduced the project's revenues and caused a suspension in the project's lending activities. Commodity sales revenues were about $2.0 million behind original estimates. USAID/Jamaica and the Foundation have effectively dealt with some of these problems but the Foundation's situation remains precarious because of the project's heavy reliance on the sales proceeds of commodities which have only limited market demand in Jamaica. As a result, it was questionable whether the project's planned objectives would be fully achieved unless additional sources of commodity revenues were developed. If they are not, then the project's objectives and operations should be adjusted to reflect current revenue levels.

Recommendation No. 1

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation, either (i) obtain a written commitment for additional funding sources which will ensure sufficient revenues to achieve original project goals or (ii) issue a Project Implementation Letter, or its equivalent, to adjust project objectives and operations in accordance with reduced commodity sale revenues.

Discussion

After two years, the project has resulted in establishing the Jamaica Agricultural Development Foundation which has approved about $2.2 million in loans, equity investments and grants in Jamaica's agriculture sector. However, commodity sales revenues are about $2.0 million behind original estimates and it appears unlikely that cheese and butter sales volumes will substantially increase in the near future.

Furthermore, the project's achievements to date would likely not have been accomplished without considerable USAID/Jamaica staff involvement and without the availability of substantial AID grant funds, neither of which were anticipated at the project's outset.

At the outset, project sponsors estimated that the sale of donated cheese and butter during the planned six years of donated commodities would generate about $25.6 million, or about $4.3 million per year. These estimates have not been achieved because of lower than expected commodity sales and higher than anticipated processing and marketing costs. For example, during the first 18 months of commodity sales JADF netted only about $4.5 million, or about $2.0 million less than originally estimated. At the current rate, the JADF would generate about $18 million, or $7.6 million less than originally anticipated.

Partially because of these reduced revenues, the Foundation temporarily suspended lending activities and requested additional USAID funding support. Since the Foundation was legally established in January 1984, USAID/Jamaica approved two grants amounting to $1.5 million.

USAID/Jamaica and JADF officials have actively sought ways to increase butter and cheese sales, and have investigated the possibilities of substituting other commodities better suited to Jamaica than cheese and butter. As of March 1986, attempts to improve butter sales had not been significantly effective, but no agreement had been formalized to replace or supplement the existing butter. The Chairman of JADF's Board of Directors did not anticipate any problems because of the reduced commodity revenues. He stated that the shortfall was probably being offset by a higher exchange rate which generated more Jamaican dollars than originally anticipated and that the Foundation's investments were generating more income than originally expected. In addition, other sources of funds were being sought, including service fees from other banks for processing their loans and additional commodity donations from the United States and Canada.

USAID/Jamaica and JADF officials had not prepared a formal written evaluation of the impact of reduced revenues on the program's objectives. Likewise, no formal written evaluation had been made of the Foundation's operations to determine if changes were warranted due to income shortfalls. This issue is discussed later in this report (page 21).

USAID/Jamaica and the Foundation need to seriously consider the effect that reduced revenues would have on achieving program objectives and identify ways of either increasing project revenues and/or improving the efficiency and effectiveness of the Foundation's operations to help offset these reductions.

Management Comments

USAID/Jamaica agreed that reduced butter and cheese sale revenues have hindered the project's progress. However, USAID/Jamaica did not believe the report gave adequate consideration to the possibility of increasing project revenues through expanded cheese and butter markets and through the sale of other donated commodities such as wheat, rice and non-fat-dry milk, as an alternative to adjusting the project's objectives and operations to reflect reduced cheese and butter revenue levels. In May 1986, USAID/Jamaica reportedly requested a Section 416 grant of wheat, rice, and non-fat dry milk in support of the JADF project.

USAID/Jamaica suggested a change to the recommendation to reflect the possibility of increasing revenues and submitted revised projected sales information for butter, cheese and non-fat dry milk showing how original project sale revenues could be achieved. USAID/Jamaica requested that the recommendations be closed based on actions taken to obtain additional revenue sources.

Inspector General Comments

USAID/Jamaica's suggested sentence changes were incorporated in the discussion. In addition, the report recommendation was changed to address the possibility of increasing project revenues through the sale of other donated commodities. However, USAID/Jamaica has not yet obtained a firm written commitment for additional commodities which would ensure that original project revenue levels would be achieved.

2. Adjustments Were Needed in the Foundation's Investment Policy

Jamaica Agricultural Development Foundation lending and investment decisions have not always been made in accordance with the original intent and purpose of this project's authorization. This condition existed because USAID/Jamaica and the Foundation had not adequately addressed and translated the program's original investment goals, objectives and concerns into a clear and detailed investment policy to ensure that only agriculture activities receive financial assistance and that the small farmer and dairy industry activities will receive preferential treatment. A precise investment/lending mandate and corresponding guidelines will better ensure that program resources will be solely used to benefit Jamaica's agriculture sector and especially those subsectors targeted for assistance at the program's outset, mainly the small farmer and activities in the dairy industry.

Recommendation No. 2

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation:

a. develop an investment/lending policy that (i) accurately reflects the original program investment goals, objectives and concerns, (ii) ensures that resources will be used strictly to finance agriculture activities, and (iii) ensures that resources will be used to benefit the small farmer and dairy industry; and

b. translate the investment/lending policy into specific but flexible guidelines that give preferential treatment to small farmers and dairy industry activities by means of lower interest rates, reduced collateral requirements or other incentives.

Discussion

The Jamaica Agricultural Development Foundation approved about $2.2 million in financial assistance to 31 Jamaican businesses and organizations since it was established in 1984. Most of the assistance has gone for agriculture-related activities. However, based on a review of the Foundation's portfolio and lending practices, it did not appear that JADF's investment/lending policy was in full agreement with the project's original intent or guidelines. There was no evidence that USAID/Jamaica has approved alternative guidelines.

For example, JADF:

-- adopted a policy of investing 25 percent of its funds outside the agricultural sector,

-- made lending decisions based on traditional conservative banking criteria, and

-- had not provided financial assistance to the dairy industry (a prime objective of the project).

JADF's project finance criteria were established in the first commodity transfer authorization between the United States Government and the Foundation. The April 10, 1984 authorization stated that the Foundation would finance "projects to increase agricultural production and to promote the growth of Jamaican agri-business involved in the production, processing, and distribution of food and agricultural products."

The authorization also listed five guiding principles upon which project financing was to be based. Priority was to be given to projects that:

-- contribute to Jamaica's long-term independence from food imports,

-- are truly private sector initiatives,

-- offer some foreign exchange benefits,

-- complement Jamaica's existing agricultural strengths, and

-- are easily manageable and have a high probability of success.

In addition, although not explicitly stated in the transfer authorization, it was understood by program sponsors that the Foundation would be a creative agriculture development organization which would focus on assisting Jamaica's dairy industry and which would take greater risks in investments than practiced by normal lending institutions. This latter point was further supported when, in June 1984, the Foundation was approved by the Government of Jamaica as a venture capital company.

Breakdown of the Foundation's Portfolio - From July 1, 1984, through March 14, 1986 the Foundation had approved 19 loans, eight equity purchases and 10 grants, totaling about $2.2 million, to 31 businesses and organizations. 1/ During this same period, another 76 financial requests were declined for various reasons including six in the dairy sector. No loan guaranties have been issued.

Horticulture, assorted crops, and beef are the investment categories which have benefited most from JADF loans and equity purchases, as shown in the following table.

Investment	Loans No.	Loans Amount	Equity Purchases No.	Equity Purchases Amount	Total No.	Total Amount
Horticulture	4	$ 424,062	3	$ 220,696	7	$ 644,758
Crops (coffee, vegetables, coconut, sugar)	5	384,451	2	116,255	7	500,706
Beef	4	434,029	-	-	4	434,029
Aquaculture	2	179,423	-	-	2	179,423
Honey	2	85,239	-	-	2	85,239
Non-agriculture	2	133,700	3	152,015	5	285,715
	19	$1,640,904	8	$ 488,966	27 1/	$ 2,129,870

1/ Five businesses received combined loan and equity financing and one business received both a loan and a grant.

Most of the 22 businesses that have received loan and/or equity financing had already been in business and used the funds to expand operations. Several of these appeared to be in good financial condition and might have qualified for conventional financing.

A total of five loans and equity purchases representing $285,715, or about 13 per cent of the total loan and equity amount approved, were invested in non-agriculture activities. These include the following:

Name of Borrower	Activity	Loan	Equity Position	Total
ACE Woodwork Ltd.	Woodcraft	$ 23,810	$ 5,495	$ 29,305
Parquet Spec. Ltd.	Parquet Flooring	109,890	73,260	183,150
Trafalgar Dev. Bank	Banking		73,260	73,260
		$133,700	$152,015	$285,715

Program eligibility for both the woodcraft and parquet flooring loans was debated among Foundation staff and board members. However, both were approved on their financial merits and both were linked to agriculture on the basis that a natural resource - wood - was used in the manufacturing of a finished product. In our opinion, the financing of woodcraft and wood flooring activities was stretching the program's intent unless these activities were tied to managing the lumber source. Neither ACE Woodwork nor Parquet Specialist were involved with forest management. See Exhibit 1 for illustrative examples of JADF-funded projects.

<u>Board Decisions Dictate Foundation Lending Practices</u> - The Foundation's Board of Directors established policies and had final responsibility for approving or disapproving project financing proposals. In June 1985, the Foundation's Board of Directors established an investment policy that targeted 75 percent of its investment funds to agriculture activities and 25 percent to non-agriculture activities.

According to the Foundation's General Manager, the Board took this action to reduce the margin of risk associated with placing all of its funds in agriculture activities, which are considered to be of higher financial risk than non-agriculture activities. The Foundation's equity purchase in the USAID created and financed, but privately owned, Trafalgar Development Bank was an example of an investment in a non-agricultural activity. Trafalgar Bank generally provided financing to non-agriculture activities, although it could also finance some agriculture activities. The Foundation's Chairman of the Board of Directors said this policy change was subject to change. He said that the intention was to use 25 percent of the funds that were available for lending to generate an income stream to support the Foundation's operations. He said these funds were to be used for certificates of deposit and for the purchase of blue chip stocks.

The policy change, however, limited the amount of funds available for agriculture activities and was therefore contrary to the program's original intent. Further, the policy change violated the conditions established by the Government of Jamaica (GOJ) because the Foundation was approved as a venture capital organization. Among the conditions to receiving venture capital status was that the Foundation would invest in agriculture or agri-business activities only. According to a former Foundation Board Director, the policy change by the Board, which would allow for non-agriculture investments, was against the project's original intent.

Furthermore, because of divergent views among Board members as to the risk position that the Foundation should take in loans, it was doubtful that some of the high-risk agriculture activities intended to be financed by the project would receive any assistance. USAID/Jamaica's Project Manager said the Board of Directors operated with a banking mentality in analyzing potential loans and grants. He indicated some board members were very conservative and were guided strictly by financial considerations without taking social or other factors into account. Two individuals denied financial assistance claimed that the Foundation did not service the small farmer but only financially sound businesses with considerable collateral.

Dairy Industry - The dairy industry was one agriculture sector mentioned most often by project sponsors that would highly benefit from the Foundation's program. Historically, this sector has been unable to meet the demand for fresh dairy products, especially milk, because of disincentives created by Government of Jamaica pricing policies and by the imports of subsidized powdered milk. Government statistics showed that during the period 1975 through 1984 powdered milk imports increased by about 40 percent, from about 8,765 tons to 12,271 tons, while the annual domestic production of fresh milk remained at about the same level.

JADF has not actively sought opportunities to assist the dairy sector. According to the Foundation's Managing Director, the Foundation has targeted its lending program to selected areas because it has not yet prepared to serve everyone in the agriculture sector. He added that much of the JADF lending activities was in those areas identified by government agencies as being high priority because of their export potential. Ornamental horticulture was in this category. Foundation project officers stated they take a conservative approach in assessing loan applications. They described dairy industry loans and equity investments as somewhat risky because of low yields on investment due to high operating costs and low prices due to GOJ policies.

A former Board Director stated that the thrust of the Foundation was to develop the dairy industry and indicated that present disincentives to dairy development should not stop a venture capital organization like the Foundation from actively pursuing dairy industry investments. The former director stated that the Foundation had not been creative enough in its approach to assisting the agriculture sector, especially the small farmer and dairy industry activities. The person further added that JADF needed to be more innovative and flexible in its financing terms.

The Foundation's Credit and Grants Manual states that, being a venture capital institution, the Foundation will take more risks and be more creative and flexible than commercial banks or other financial institutions. Given these conditions it appeared that the Foundation could tailor its credit terms by specific agriculture activity in order to achieve desired objectives. For example, instead of assessing the same interest rate for all agriculture loans, as it is now doing, the Foundation could vary the interest rate by agriculture sector or activity, thereby providing a lower subsidized rate to those sectors or activities facing greater obstacles, such as those found in the dairy industry. Conversely, those agriculture activities facing fewer obstacles or which have received substantial assistance, such as horticulture activities, could be charged higher rates to help absorb the risks and costs of helping the dairy industry.

Management Comments

USAID/Jamaica did not agree that additional measures were needed to ensure that program resources were used in accordance with the original intent and purpose of the project's authorization. USAID/Jamaica stated that the project has achieved its primary goal of mobilizing a new and needed private sector resource base for Jamaica's agriculture and agri-business development effort. Furthermore, USAID/Jamaica took exception with the report findings that JADF has made loans to non-agriculture activities, not actively sought opportunities to assist Jamaica's dairy industry, not complied with conditions established by the GOJ when it approved JADF as a venture capital organization, and not demonstrated a willingness to take greater risks in investments than practiced by normal lending institutions. USAID/Jamaica requested that the recommendation be closed, since it considered that the JADF was already acting in accordance with the recommendation.

Inspector General Comments

A review of JADF project's original investment goals and objectives clearly shows that the purpose of the Foundation was to provide a needed resource base to finance Jamaica agriculture activities which experience difficulties in obtaining conventional financing such as the small farmer and activities in the dairy industry. A review of the Foundation loan activity does not support the Mission's claim that the Foundation is actively assisting these agriculture sectors. The audit disclosed that the Foundation's loan approval decision process was based on conservative banking financing criteria which generally precluded any assistance to the small farmer and to dairy industry activities. An investment policy and corresponding guidelines which accurately reflects the program's investment goals and objectives will better ensure that project resources will be used to benefit those agriculture subsectors targeted for assistance at the program's outset.

3. Potential Conflicts of Interest Could Damage the Project's Credibility

The Jamaica Agricultural Development Foundation was influenced by representatives from those Jamaican and American companies who were involved in the Foundation's development and who remain actively involved in its operations. These relationships were beneficial to the Foundation, especially during its early development stages. However, these relationships also benefited the companies with representatives on the Foundation's Board. This potentially serious conflict of interest situation occurred because the Foundation's Articles of Association do not adequately preclude Board members or their employers from directly benefiting from Foundation operations and investments. The situation needs to be corrected, otherwise JADF could be abused and become subject to serious criticism affecting its credibility and overall effectiveness.

Recommendation No. 3

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation, amend the Foundation's Articles of Association to preclude Foundation Board members from directly benefiting from Foundation investments; and to ensure that they will absent themselves from any consideration of transactions between the Foundation and themselves or companies they represent; and that in the case of any such transactions or investments there shall be specific recorded determinations that the transaction is in the Foundation's interest or the investment is being made pursuant to Foundation policies with full knowledge of the potential conflict.

Discussion

The idea for the Jamaican Agricultural Development Foundation Project was conceived early in 1983 by Land O'Lakes Inc. (LOL), a food and agricultural cooperative located in Minnesota, while working under a 50 percent matching grant project funded by AID/Washington providing technical assistance and training to foreign agricultural cooperatives. The idea was discussed and further developed with AID and Jamaican private and government officials, and culminated in a September 1983 formal project proposal; subsequently, on January 5, 1984, the Foundation was legally established as a Jamaican non-profit organization.

Conflict of Interest Concerns - During the project's developmental phase AID officials and others expressed concern over the potential for self-dealing and conflict of interest. For example:

-- In a memorandum dated August 4, 1983, to the Mission Director from USAID/Jamaica's Office of Program and Economic Planning, the OPEP's officer said he thought "there would be a possible conflict of interest if any processors (Grace, Kennedy) or suppliers (LOL) were on this [Jamaica Agricultural Development Foundation's] Board."

-- In a memorandum dated December 1, 1983, to the Deputy Mission Director from AID's Regional Legal Advisor, USAID/Jamaica was advised to: "discuss and examine whether there are potential organizational conflicts of interest and, if so, what can be done to assure that abuses do not occur. In short, LOL/GK should not be placed in a position which would bias their judgement. They should not be permitted to participate in decision-making procedures of JADF which could affect their own financial interests. JADF rules should be clear on this point."

-- In a letter dated February 17, 1984, to the then USAID/Jamaica Project Officer from the General Counsel of the Council on Foundations, Inc., which AID requested to review the legal and operational status of the newly formed Foundation, it was advised that "since the Foundation hopes to carve out a reputation as an independent, private sector financing resource, free from government influence, its reputation and integrity throughout should not be sullied by acts of self-dealing or conflicts of interest." With regard to "self-dealing", the Counsel advised that the Foundation use the "necessary" and "reasonable" tests. "For example, rent paid or banking services paid for the foundation to businesses represented on the Board would not be illegal so long as the rent or fees paid were necessary for the operation of the Foundation and reasonable in amounts. On the other hand, any grants, loans, or equity investments in organizations should be more closely scrutinized. For example, a grant, loan or investment in a for-profit business (such as a dairy or farm) where a Board member is part owner should be strictly avoided."

The potential "self-dealing" and conflict of interest concerns expressed in these documents did not result in any specific restrictions on Board membership. The only reference to membership qualifications is in Article 4 of JADF's Articles of Association which specifies that "the qualifications for membership in the Foundation shall be determined by the Directors and such criteria may be made available to the public."

The Appearance of Conflict of Interest - Several companies have benefited by their relationship with the Foundation. These include the following:

Grace, Kennedy, & Co. Inc. is one of the largest companies in Jamaica. The company has ownership interest in foods, insurance, shipping and other businesses. Several of its members, including the chairman of the Board of Directors, have contributed greatly to the establishment of the Foundation. Three of its members were among the founding seven who signed the Foundation's Memorandum of Association in January 1984. Since then Grace, Kennedy, & Co. Inc., has always been represented on the Foundation's Board of Directors. Initially, two of the six Board Directors with voting rights were employed by this company. In addition, the Foundation's Board secretary has always been employed by Grace, Kennedy, & Co. Inc. Recognizing the potential problems that may have occurred by having two voting directors from this company, the Foundation's Board of Directors subsequently took measures to limit the number of directors from any company to one.

Grace, Kennedy, & Co. Inc. appears to have benefited from business dealings between the Foundation and Dairy Industries, a subsidiary of Grace, Kennedy, & Co. Inc., which was contracted with by JADF to process the PL-480 Title II cheese and butter donated under the program. Dairy Industries is the only cheese and butter processor in Jamaica capable of handling large volumes of these commodities. Because of this monopoly position, Dairy Industries has benefited since the beginning of the project from processing and marketing fees as well as from technical assistance provided to it under the project. Having access to the Foundation's strategy and decision making process provided an unfair advantage to Grace, Kennedy, & Co. Inc. and its subsidiary Dairy Industries. Both appeared to have benefited under this arrangement.

This arrangement benefited Dairy Industries in settling an end-of-contract claim against the Foundation. In October 1985, Dairy Industries presented a $1.3 million claim to the Foundation for additional costs incurred under its first year processing contract, which ended in August 1985. The Foundation's accountants agreed to about $568,000 of the claimed amount but disputed the balance of the claim on the basis that the expenses were not authorized under the contract agreement. One item in dispute was the amount included for management fees charged by Dairy Industries' parent company, Grace, Kennedy, & Co. Inc. The almost $200,000 charge was about eight times higher than expected under the contract terms. During the next four months the claim amount was discussed and negotiated among the Foundation, Dairy Industries and Grace, Kennedy, & Co. Inc. and was finally settled, at USAID/Jamaica's behest, at about $824,000. USAID/Jamaica's Project Manager stated that the claim was probably settled at about $60,000 to $80,000 higher than his analysis indicated was fair, but that this was better than having the claim continue to litigation, thereby dominating JADF and USAID management time and thereby having it jeopardize the project. He said it would have been difficult to get Grace, Kennedy, & Co. Inc. to come further down in its demands.

Financial assistance was also provided by the Foundation to two agriculture sector ventures in which Grace, Kennedy, & Co. Inc. has financial interests - Lyford Farms Ltd., which received a $183,150 loan and a $6,410 grant, and Produce Packers Ltd. (formerly Jamaica Fresh Produce Ltd.), which received $61,310 equity financing. It should be noted that Jamaica Fresh Produce Ltd. went bankrupt, and that JADF lent to it at USAID urging. In addition, the Foundation frequently used another Grace, Kennedy, & Co. Inc business - Grace, Kennedy Travel Agency for travel services, especially in arranging air transportation for Foundation Board members residing in the United States. We were told that Grace, Kennedy Travel has been used much more than other travel agencies, even though the others are more conveniently located to the Foundation's office. During the period July 1984 through February 1986, the Foundation spent about $15,000 on airfare to bring its U.S. Board members to Jamaica to attend Board meetings.

Land O'Lakes was responsible for the project proposal and has been instrumental in the Foundation's development and management ever since. Land O'Lakes (LOL) is represented on the Foundation's Board by its Vice

President of International Development and Governmental Affairs Division. Because of their expertise in dairy commodities, especially in the processing of cheese and butter, LOL has received Foundation technical assistance contracts. Since the middle part of 1984 through October 1985, LOL has received over $185,400 for its technical assistance services.

In addition to these contracts, LOL sold about 100 metric tons of cheese to the Foundation. To rectify a potential problem with deteriorating cheese, LOL recommended to the Foundation that younger cheese, 1 to 2 months old, be acquired and blended with existing stocks of aged cheese. As there was no young cheese in inventory nor in the PL-480 commodity pipeline, the Foundation had to purchase the cheese on the open market. Because of its working relationship with LOL the Foundation requested them to provide the necessary cheese. The Foundation paid about $400,000, including shipping costs, which was reportedly about three times the world market price. It was subsequently reported that the young cheese may not even have been needed. The Foundation reportedly lost about $183,150 on this transaction after the cheese was blended and sold.

Jamaica Citizens Bank - The Chairman of the Foundation's Board of Directors was also the Chief Executive Officer of Jamaica Citizens Bank. He received no salary or fees from his role in JADF. The revenues from the sale of the donated PL-480 Title II commodities were deposited into an account in the Jamaica Citizens Bank. An operational account was also maintained there. As of March 2, 1986, these account balances were $61,810 and $6,330 respectively. In addition, according to the Foundation's Financial Summary ending February 28, 1986, the Foundation had about $675,800 invested in certificate of deposits at Jamaica Citizens Investment Ltd., an affiliate of Jamaica Citizens Bank. According to the Foundation's General Manager, the decision to use the Jamaica Citizens Bank was based on the services it provided which were said to be better than those offered by other banks. There was no evidence that the rates and services were detrimental to JADF.

The Law Firm of Tenn, Russell, Chin Sang, Hamilton & Ramsay - This firm was involved in establishing the legal status of the Foundation and has remained as its primary attorney. One of the law firm members is the brother of one of JADF's former Directors. Until recently, Foundation clients were required to use this law firm for preparation of legal documents required by the Foundation. Some of these clients have strongly complained that legal fees charged by this firm were higher than the norm. One loan recipient we talked to claimed he was over-charged by about $700 by this firm.

According to the current USAID/Jamaica Director, regardless of the underlying facts, the mere appearance of "self-dealing" or conflict of interest can be just as damaging as if it were actually occurring. He was concerned, however, that the situation should be analyzed and dealt with without detracting from the contributions made by the various participants, and without harming the reputations of public spirited people who acted with the full knowledge and concurrence of previous Mission management.

Membership qualification provisions should be adopted to prevent "self-dealing" and conflict of interest situations from occurring. Action should be taken to ensure that required services -- travel. banking, legal, etc. -- are procured from all qualified sources instead of from only those entities linked to the Foundation. Another step that can be taken is to replace the present Secretary of the Board of Directors with someone who has no other links with the Foundation.

Management Comments

USAID/Jamaica generally agreed that the JADF project had the potential for self-dealing or conflict of interest. It did not agree, however, that the examples discussed in the report demonstrated an existing self-dealing or conflict of interest problem. Nevertheless, it suggested wording changes to the report's recommendation to better ensure against such occurrences.

Inspector General Comments.

The report's discussion of the conflict of interest clearly demonstrates an awareness of this potential problem from the project's inception. Failure to take appropriate corrective actions will only add additional opportunity for real of apparent conflicts of interest situations to develop. USAID/Jamaica's suggested wording changes for the recommendation and for parts of the discussion were incorporated in the final report.

4. Grant Repayment Requirements Were Not Adequately Monitored

As of March 27, 1986, USAID/Jamaica had not required the Foundation to repay a $500,000 reimbursable grant which, according to the grant agreement, was to be repaid on September 30, 1985, following USAID/Jamaica's written instructions as to the form and means of repayment. In addition, USAID/Jamaica violated AID policy (AID Handbook 3, Chapter 6) and a Government of Jamaica agreement when it amended the grant agreement on November 8, 1984 because (1) repayment terms were modified in such a manner that the grantee could possibly pay back less than the equivalent of $500,000, and (2) USAID/Jamaica did not obtain the Government of Jamaica's approval as required under the grant's funding source project agreement. As a result, the United States Government has incurred interest costs of about $16,000 during the six-month period that actual USAID/Jamaica disbursements have remained unrecovered and unavailable for other projects.

Furthermore, Mission officials said there may be other reimbursable grants in their portfolio which have not been repaid because of inadequate accountability controls over such grants. As a result, the United States Government may be incurring additional interest and/or opportunity costs.

Recommendation No. 4

We recommend that USAID/Jamaica:

a. revoke the November 8, 1984 amendment to the April 26, 1984 grant agreement, and require that reimbursement be made as originally prescribed in Attachment 1, Section E (2) of the agreement;

b. issue written instructions to the Jamaica Agricultural Development Foundation requesting reimbursement in full of the funds disbursed;

c. designate a USAID/Jamaica approved project which is to be the recipient of the reimbursable grant and, if no such entity can be designated, advise the Foundation that repayment be made directly to the Mission;

d. review the Mission's portfolio for other reimbursable grants and ensure that recoveries be made in accordance with their funding authorization; and

e. establish Mission accountability controls to ensure that current and future reimbursable grants are properly prepared, monitored and managed.

Discussion

On April 26, 1984, USAID/Jamaica approved a bridge financing grant to the Foundation for the equivalent of $500,000 ($310,000 plus the equivalent of $190,000 in Jamaican currency). The grant agreement provided that, unless otherwise agreed to by AID in writing, the grantee would reimburse

AID the total amount of funds disbursed under the grant in Jamaican dollars, and that reimbursement of the U.S. dollars would be converted "at the highest rate of exchange which is lawful in Jamaica on the date of reimbursement to AID." The grant agreement also provided that reimbursement would be due on September 30, 1985, and would be made by the Foundation pursuant to AID written instructions. As of March 27, 1986, USAID/Jamaica had not specified who should receive reimbursement of the approximately $415,100 disbursed under the grant.

Funds for the grant came from USAID/Jamaica's Technical Consultation and Training Grant Project (532-0079). According to USAID/Jamaica's Controller, this project provides grant funds to many entities involved with developing Jamaica's private sector. He added that all grants made under this project require the approval of USAID/Jamaica and the Government of Jamaica.

At the request of the Foundation, on November 8, 1984, USAID/Jamaica amended the grant agreement repayment provision to allow the Foundation to convert the U.S. dollars disbursed under the grant at the highest lawful exchange rate in effect at the time of each AID disbursement instead of at the time of reimbursement to AID as originally prescribed. On April 3, 1985, USAID/Jamaica again amended the agreement to extend the period that expenditures were authorized under the grant by eight months from April 30, 1985 to December 31, 1985.

The November 8, 1984, grant reimbursement amendment was not valid because it (1) contradicts the grant provision and general AID policy of requiring exchange rate conversions at the highest lawful rate on the date of reimbursement and (2) was approved only by USAID/Jamaica, and not by the Government of Jamaica and the Mission as required. As a result of this amendment, reimbursement may yield less than the equivalent of $500,000 which grant approval was conditioned upon.

Grant Status - As of March 1986, USAID/Jamaica has not issued any reimbursement instructions to the Foundation. The Foundation, in turn, has asked for a waiver not to repay the Grant, arguing that grant funds were primarily used to provide technical assistance to the local processor involved with processing the Foundation's donated cheese and butter commodities and for general operating expenses incurred during JADF's early months of operation. Foundation officials have also argued that repayment may, to some extent, affect the JADF's cashflow and future investment opportunities in Jamaica's agriculture sector. These officials have been encouraged in their petition by officers from the USAID/Jamaica's Office of Project Development and Support who recommended that the USAID/Jamaica Mission Director waive the repayment requirement. During the audit, the Mission Director refused to waive repayment to a designated recipient as originally required.

Waiving the repayment requirement would have been inappropriate and unjustified. In this report we question some of the Foundation's operating expenses which appear excessive for a non-profit organization. Waiving the grant repayment requirement would send the wrong signal to the Foundation and possibly encourage more wasteful spending. Secondly, as of March 1986, the United States Government has given or made available about $7.5 million ($5.9 million equivalent of commodity donations and $1.6 million in grant funding) to JADF, not including about $800,000 in commodity ocean transportation costs. The Foundation has used these funds to generate assets totalling about $5.4 million. In addition, the program provides for another three and a half years of United States commodity donations to the Foundation. Finally, although it would like to see the repayment requirement waived, JADF has acknowledged its responsibility and has for some time included a grant repayment amount in its financial reports under the accounting category long-term liabilities.

Careless Grant Administration - Administration of this grant, as amended, has been made difficult because of mistakes and errors made during its preparation and implementation. Some of these are as follows:

-- Technical Consultation and Training Grant Project funds -- the funding source for the Foundation grant -- were disbursed prior to receiving authorization from the Government of Jamaica, which was a requirement under this Grant Project. As a result, approval was not obtained from the Government of Jamaica until seven months after the first disbursement. In addition, USAID/Jamaica Controller's office released grant funds without prior issuance of a Project Implementation Letter authorizing such action.

-- The April 3, 1985 amendment to the grant agreement extending the period that expenditures were authorized under the grant from April 30, 1985 to December 31, 1985, did not extend the grant's repayment date of September 30, 1985. As stated, repayment was due prior to all disbursements being made.

-- The November 8, 1984 amendment to the grant agreement which allowed for the conversion of U.S. dollars to Jamaican dollars based on the exchange rate at time of disbursement versus reimbursement, was unclear as to what time period it actually covered. As stated, it could be interpreted as covering either from November 8, 1984, to March 1, 1985, or from April 26, 1984, to March 1, 1985.

-- Finally, the Grant shows actual amounts in both U.S. and Jamaican dollars. Showing actual Jamaican dollars instead of providing for the equivalent of U.S. dollars in Jamaican currency creates accounting and reimbursement problems because of exchange rate fluctuations.

Other Reimbursable Grants - USAID/Jamaica officials were unsure whether or not there were any other reimbursable grants in their project portfolio because they had no system to keep track of such grants. The Mission Director indicated that there were more of these grants and had asked his staff to research how many were in existence. Because of the potential for other reimbursable grants in the Mission's portfolio the report includes recommendations for follow-up on this matter.

Mission Comments

USAID/Jamaica agreed with the finding and has taken action to fully implement all but part "a" of the recommendation. With respect to this part of the recommendation, the Mission stated it had instructed JADF to repay the disbursed portion of the US$500,000 grant as required in the amended grant agreement, which allows the Foundation to convert the U.S. dollars disbursed under the grant at the highest lawful exchange rate in effect at the time of each AID disbursement instead of at the time of reimbursement to AID as originally prescribed.

The Mission stated that although it found no basis for the audit report's allegation that AID policy requires that reimbursement of U.S. dollars be converted at the highest lawful rate of exchange on the date of reimbursement to AID, it was willing to reinstate the original formula if required.

Based on the amended agreement, USAID/Jamaica calculated that the Foundation will repay US$248 less than it would have been required under the original agreement terms and based on the small difference requested that the recommendation be closed.

Inspector General Comments

USAID/Jamaica has provided adequate evidence that it has implemented parts b, c, d, and e of the recommendation. With respect to Recommendation No. 4a, it is AID policy to obtain the highest lawful rate of exchange in effect at time of conversion of U.S. dollars to local currency. Regarding the JADF grant, conversion of U.S. dollars to Jamaican dollars occurred at the time of reimbursement to AID. Therefore, the repayment terms of the original agreement were correct and should not have been amended. Furthermore, as stated in the report, the amendment was not valid as it was unilaterally approved by USAID/Jamaica without the required approval of the GOJ. This recommendation will be closed upon receipt of evidence that the November 8, 1984 amendment to the grant agreement has been revoked and that the terms of repayment as originally prescribed have been fully met.

5. Project Oversight Needs to be Strengthened

USAID/Jamaica had not adequately monitored the use of, or the continued need for, project funds. USAID/Jamaica was responsible for monitoring the Jamaica Agricultural Development Foundation Project to ensure that PL-480 Title II sale revenues and AID grant funds are used in accordance with their intended authorized purposes. The Mission has not been able to monitor this project as closely as needed, partly because of other time-consuming project-related problems. As a result, (1) funds which could be used to develop Jamaica's agriculture sector were used instead to pay questionable Foundation operating expenses, and (2) unnecessary AID grant funds were not reprogrammed or deobligated.

Recommendation No. 5

We recommend that USAID/Jamaica:

a. require the Jamaica Agricultural Development Foundation Project Manager to review project expenditures quarterly to ensure that project revenues and grant funds are being used in accordance with their funding source authorizations;

b. request AID's General Counsel for an opinion as to the appropriateness of funding entertainment expenses and subsidizing the private use of project vehicles from funds generated from the sale of PL 480 Title II commodities and to take appropriate action based on the opinion;

c. reprogram or deobligate grant funds budgeted for the unfilled marketing specialist position;

d. evaluate the continued need for the existing full-time marketing specialist and, if this position is no longer required, reprogram or deobligate the remaining budgeted funds; and

e. review the remaining Operational Program Grant line items to determine if the budgeted amounts are still justified under current conditions and, if not, make appropriate adjustments.

Discussion

Revenues generated from the sale of donated PL 480 Title II commodities were used to finance Jamaica's agriculture development activities, and for JADF's operating expenses. Lower operating expenses would leave more funds available for Jamaica's agriculture. This was especially critical because actual revenues available to the Foundation were less than originally planned.

Questionable Operating Expenses - JADF operating expenses included certain cost items which appear questionable and/or unnecessary to the achievement of project goals. Two examples were the costs for personal use of Foundation vehicles and entertainment. According to the JADF's

Financial Manager the Foundation paid for all operating and maintenance costs for the five vehicles assigned to the Foundation's staff. These vehicles were assigned full-time to the staff. In addition, the JADF has provided to the same five employees credit cards which are used for business-related expenses including entertainment. He said that, for example, entertainment expenses included paying for meals for clients and bank officials. During the first eight months of the Foundation's current fiscal year, the Foundation spent about $11,900 on motor vehicle and $8,700 for entertainment expenses. The amount of vehicle expenses attributable to personal use was not known. In lieu of subsidizing the personal use of vehicles and entertaining clients and bank officials, these funds could have been used for agriculture development activities. It does not appear that the Foundation's focus was consistent with the project's original intent or that its priorities were in order when it spent more on expenses like these than it had on assisting the dairy agricultural sector. One former Foundation Board Director was concerned that the Foundation's operations were not efficient and that management appeared to be "empire building".

Reduction In Grant Fund Needs - On August 30, 1985, USAID/Jamaica approved a $1 million Operational Program Grant for the purpose of reinforcing the capacity of the Foundation to do better loan and equity financing. Specific budget elements to be covered during the three year grant period include:

Element	Obligated Amount
Technical Assistance	$ 500,000
Training	50,000
Commodities	150,000
Personnel	135,000
Public Relations	62,000
Other Support Costs	103,000
	$1,000,000

Neither the Foundation's nor USAID/Jamaica's project files contained information fully justifying the need for this amount. One USAID/Jamaica official involved with reviewing the Grant proposal said the budgeted amounts were not justified. The Foundation's Financial Manager was also unable to fully explain the differences and/or relationship between certain sub-items within the budget categories, and mentioned that some planned items may no longer be required.

For example, included in the grant amount was $50,000 for two marketing officers. These positions were planned to assist in marketing the processed cheese and butter products in order to increase sales, thereby increasing the JADF's revenues. The Foundation contracted one of the two planned marketing officers in December 1985. The Financial Manager said he did not believe there was a continued need for two marketing officers since the Foundation had extricated itself from the marketing of finished products. He said that, under the current arrangement, JADF sells bulk quantities to interested buyers prior to having them shipped from the United States. He indicated that the existing marketing specialist would work on expanding the overall market demand. A former JADF Director questioned the need for any marketing consultant, especially under an arrangement where bulk commodities are sold directly to processors.

It is even questionable whether the Foundation should have hired a marketing officer under the old processing arrangement. That processing agreement, which was signed on July 20, 1984 with Dairy Industries provided that the processor would be entitled to a fee of 10 percent of the product sales for marketing the finished products.

Because there was no longer a requirement for two marketing specialists, USAID/Jamaica needed to ensure that the unnecessary funds are reprogrammed or deobligated so as not to incur opportunity costs. Furthermore, the Mission should reexamine the need for and/or use of the existing marketing officer and the other budgeted grant items in view of the new commodity sales arrangement and questionable support for some of the budgeted items. If the examination reveals other adjustments are warranted, USAID/Jamaica should make them and continue to monitor the grant in accordance with AID regulations.

<u>Monitoring Responsibility</u> - USAID/Jamaica had not closely monitored all aspects of this project, in part because it has been busy resolving commodity-related problems. However, this project, possibly more than others, requires close attention because of its unique funding concept, diverse project components, and because it was being administered by a newly established private voluntary organization whose employees were unfamiliar with AID procedures and regulations.

Management responsibility for the Foundation project was split between two Mission offices. Primary project management responsibility rests with a newly hired personal service contract (PSC) employee assigned within the Office of Project Development Support. This employee has a strong banking background, which was considered important to analyzing this as well as other Mission projects with intricate financing elements. However, the PSC manager has no previous AID experience. Also actively involved with the project was a PSC commodities specialist who was assigned with the Office of Program and Economic Planning. This person was involved with all commodity related-matters. Although occasional differences of opinion have arisen, no major difficulties have been reported due to this shared responsibility. The Office of Project Development Support's Director personally monitored the project prior to the PSC arriving in late 1985. He continues to backstop the activity.

The Office of Agriculture and Rural Development was not involved in the management of this project although the project goals and objectives were to help develop Jamaica's agriculture sector. Two USAID/Jamaica employees expressed the view that the project should be managed by the Office of Agriculture because of its agriculture focus and expertise.

However, the head of the Office of Agriculture did not believe management responsibility should be transferred to his office because of the office's existing large work load and because he thought the Office of Project Development Support was adequately managing the project. He added that he was kept informed about the project through reports and quarterly project review sessions.

Based on the issues that have been discussed in this report, we believe the Mission should take appropriate action to ensure that the pilot project is monitored more closely and that project funds are actually needed and being used efficiently and effectively. In this regard, the Mission's existing project management arrangement should be evaluated to determine if it is appropriate for this type of project.

Management Comments

USAID/Jamaica implemented part "a" of the recommendation and had begun the review of the operational program grant line items as recommended in part "e". It has included parts "d" and "c" in this review and will forward the results as soon as the review is completed.

With respect to the use of project vehicles for personal use and the use of project funds for entertainment expenses, USAID/Jamaica stated that it was a standard practice in the Jamaican business community to provide, among other benefits, use of company-owned vehicles, as part of the overall employee benefit and salary package in order to reduce the amount of income tax liability. The Mission also pointed out that the audit report did not indicate what portion of the cost might be for personal use. In regard to the use of project funds for entertainment purposes, USAID/Jamaica indicated that these funds were used for representational purposes and to further the goals of the Foundation. USAID/Jamaica said neither of these uses contravene any regulation or guidance which the Mission is aware of regarding use of funds initially generated from monitized commodities. Nonetheless, the Mission stated it would continue to review these expenditures to ensure that they are limited in amount and contributing to the ultimate goals of the Foundation. The Mission stated it would also ask the Foundation to review these procedures for the same purpose but did not believe these expenditures should be prohibited.

Inspector General Comments

USAID/Jamaica has implemented part "a" of the recommendation and it is therefore closed upon issuance of the report. The final disposition of parts "c", "d", and "e" will be determined upon completion of review of the operational program grant line items.

We recognize that the use of funds initially generated from monitized commodities is a gray area, and an area which should be addressed by AID. Because USAID/Jamaica plans to continue to review automobile and entertainment expenses to ensure that they are limited in amount and contribute to the ultimate goals of the Foundation we have revised the draft recommendations on this issue. Instead of (1) ensuring that the Foundation restrict the use of its vehicles for business purposes and/or require reimbursement for personal use, and (2) ensuring the Foundation discontinue the practice of funding entertainment expenses, we are recommending that USAID/Jamaica request AID's General Council for an opinion as to the appropriateness of funding such activities from donated commodity sales revenues and, based on this opinion, to take appropriate action.

6. Remaining Commodity Problems Need to be Resolved

United States donated PL 480 Title II cheese and butter commodities have not generated the sales volume that was estimated in the Jamaica Agricultural Development Foundation Project proposal. Butter, in particular, did not meet initial expectations. The Foundation has in inventory over 1200 metric tons of donated butter which has, for the most part, been in cold storage since July 1984. It also appears to be legally responsible for 211 metric tons of additional butter brought in independently of the donated commodities to satisfy commercial import shortages. Based on the average monthly sales volume, it will take another one and a half years to draw down the 1200 metric tons of donated butter if it does not deteriorate first. In the meantime, storage costs continue to erode JADF's revenues. USAID/Jamaica and the Foundation have been successful in reducing the levels of aged cheese in inventory through special sale arrangements, however, they have been unable to do the same with butter because of its limited market appeal. USAID/Jamaica has been developing butter marketing options, but, no decisive action has yet been taken.

Recommendation No. 6

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation:

a. analyze each of the butter marketing options, as presented by the Mission's Commodity Specialist, and take decisive action on those which can be justified under PL 480 Title II legislation and which result in a significant reduction in inventory levels;

b. request, in the interim, that the contracted food processor and other parties involved with storing the butter accept the equivalent dollar amount in butter in lieu of dollar payment to cover storage and other related costs; and

c. delay calling forward any more butter until existing inventories have been disposed of or committed, and until an advance sales agreement has been arranged.

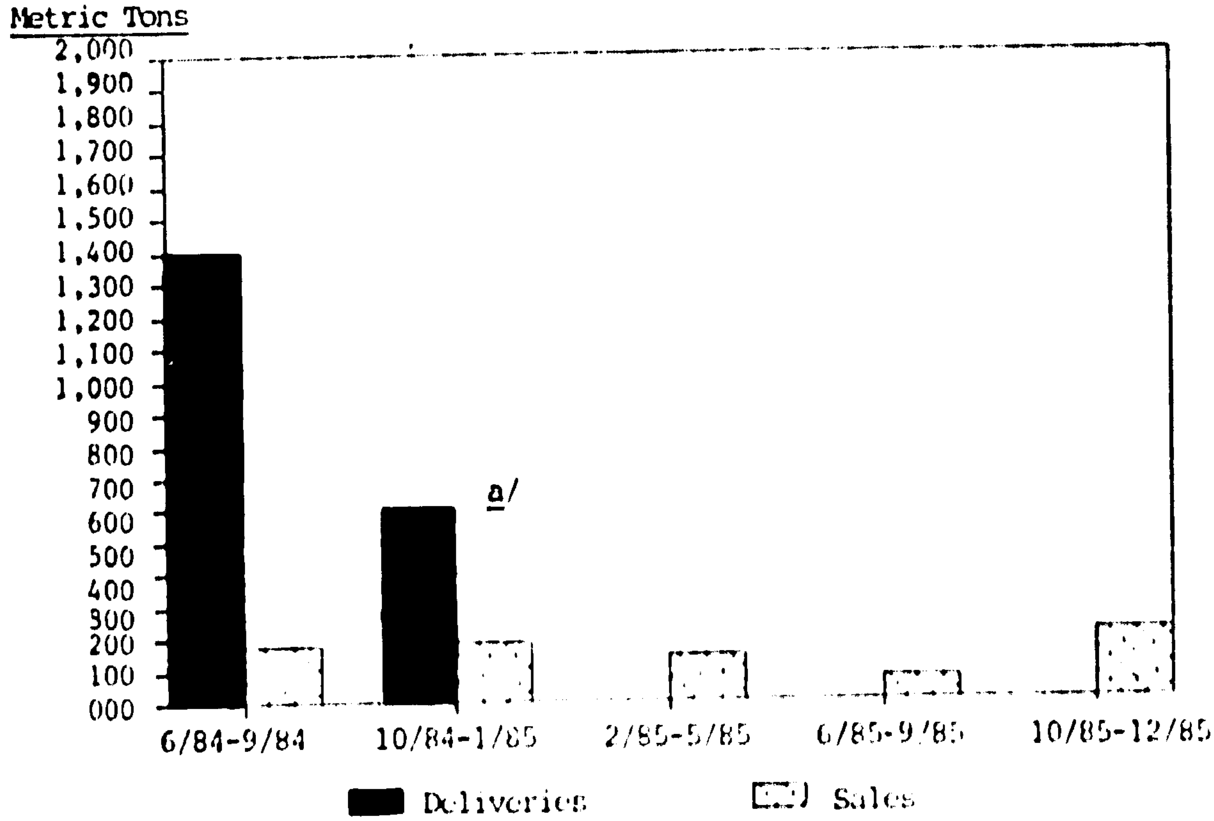
Discussion

Sponsors of the Jamaica Agricultural Development Foundation Project claimed at the project's outset that although a decline in per capita consumption of butter was observed, a steady demand for the commodity, especially among higher economic levels, was still in place. Contrary to expectations, butter showed little market demand during the 18 months it was available. As a result, as of March 14, 1986 inventory levels were exceedingly high at 1,200 metric tons. Only 800 metric tons of the 2,000 metric tons originally delivered were sold. Although there was considerable processing problems with cheese, the demand for this product was greater than for butter. In addition to the initial 2,000 metric tons delivered in 1984, more cheese was ordered.

The revenues from the sale of both cheese and butter were expected to provide the Foundation with an endowment of about $25.6 million over a six-year period, or about $4.3 million per year. However, because of reduced butter sales and other reasons, project revenues are running about $2 million less than anticipated. As of December 31, 1985, cheese and butter sales have generated gross revenues of $4.9 million and $1.5 million respectively for a total of $6.4 million. During this same period marketing and processing costs totaled about $2 million. 2/ Net revenues were therefore, about $4.4 million.

From the start it was noticed that there were and would continue to be marketing problems with butter:

Butter Deliveries and Sales Volume During The Period June 1984 Through December 1985



a/ No deliveries were requested after the initial 2,000 metric tons arrived.

2/ This amount does not include $824,176 in marketing and processing costs paid to the contractor in February 1986 in settlement of a contract claim.

As the graph shows, butter deliveries totaling 2,000 metric tons arrived over a 5 month period. In 16 months, only 789 metric tons, or about one-third, was sold.

The average butter sales volume during the sixteen-month period September 1984 through December 1985 (during which processed products were first available) was 49.3 metric tons per month. Based on this average sales volume it will take another two years to draw down the remaining 1,211 metric tons of butter assuming the butter does not deteriorate in the meantime. USAID/Jamaica officials said that slow sales were due to the availability of lower-priced substitutes (e.g. margarine), and a preference by Jamaicans for butter with less salt content than found in the U.S.-donated butter.

Even though it appeared that by early 1985 butter sale volumes would be insufficient to draw down inventories in a reasonable time frame, we did not find any evidence that USAID/Jamaica or the Foundation took any substantive corrective action to deal with this specific problem until the latter part of 1985. In the last quarter of 1985 product advertising was increased, discounts were offered, and a marketing specialist was contracted. These efforts, did not have a significant effect on sales however. In January 1986, during a quarterly review of the project the Mission Director requested the Mission Commodity Specialist to prepare a list of marketing options for reducing the butter inventory levels. This options paper presented eight options which were still being considered, among others subsequently suggested, at the end of the audit. The Mission cannot afford to allow the matter to remain unresolved, as maintaining a large inventory of aging butter seriously prevents achieving JADF's goals and objectives.

Usual Marketing Requirements - Further exacerbating the above situation is that in addition to the 1,200 metric tons of butter currently in inventory, JADF appears to be legally responsible for 211 metric tons of butter brought in to satisfy commercial import shortages.

The Foundation, in addition to its other activities, also has to ensure that commercial importers of butter and cheese are not adversely affected or displaced by the importation of donated commodities under the project. To do this, targets for butter and cheese are annually established based on the average commercial imports into Jamaica during the five preceeding years. These target amounts, known as the Usual Marketing Requirements (UMR), are monitored by JADF. The Foundation was expected to take action to make up the difference if actual imports are less than the UMR targets.

This occurred with butter in 1985. To make up the shortage of commercial butter imports, the Foundation arranged with its contracted processor, Dairy Industries, a regular commercial importer of butter and cheese, to purchase 211 metric tons of butter to meet the expected UMR shortages. In September 1985, unsalted Danish butter was purchased by Dairy Industries for about $275,000, under a bank guaranty for which JADF was still liable. However, Foundation officials said the butter would most likely be sold quickly resulting in no actual outlays of Foundation funds. As of February 1986, the butter was still in storage and Dairy Industries has subsequently requested the Foundation to cover their bank guaranty which the Foundation agreed to do. If this butter was not quickly sold it appeared the Foundation would have to make payment as agreed, further reducing its project revenues.

Mission Comments

USAID/Jamaica reported that on April 11, 1986, JADF had sold all remaining butter to Dairy Industries. It also reported that on May 27, 1986 it had requested a Section 416 grant of wheat, rice and non-fat dry milk with all sales proceeds going to JADF. USAID/Jamaica also stated that new procedures have been established that will prevent a recurrence of inventory buildup.

Inspector General Comments

The recommendation will be closed upon receipt of documentation supporting the sale of the butter inventory to Dairy Industries.

B. Compliance and Internal Controls

1. Compliance

The audit disclosed three compliance exceptions:

-- Jamaica Agricultural Development Foundation investment/lending practices were not in compliance with the project's original intent. As a result, certain targeted agricultural subsectors have not benefited from project operations and resources (see Finding 2).

-- Grant funds were disbursed prior to obtaining required approvals (see Finding 4).

-- Grant repayment provisions were not complied with and, as a result, the United States Government has unnecessarily incurred interest costs and funds are not available for other projects (see Finding 4).

Other than the conditions cited, tested items were in compliance with applicable laws and regulations, and nothing came to our attention that would indicate that untested items were not in compliance.

Internal Controls

The audit disclosed internal control weaknesses in the following areas:

-- USAID/Jamaica had not established adequate controls to track reimbursable grants. There were indications that the Mission's portfolio contains reimbursable grants which may not have been repaid as required. As a result, the United States Government may be incurring interest and/or lost opportunity costs (see Finding 4).

-- JADF had not established adequate commodity accountability controls and reporting requirements. As a result, it has been difficult to reconcile bulk deliveries with finished products, and there is no assurance that all cheese and butter deliveries have been properly accounted for (see following section).

With the above exceptions, both USAID/Jamaica and JADF appeared to have adequate internal controls over the receipt and disbursement of project funds.

C. Other Pertinent Matters

Six other issues were identified during the audit. First, it was reported that many Mission officers do not take seriously the annual vulnerability assessment. One official referred to it as a "joke" and said that the previous Mission Director had not shown any interest in it. Office of Management and Budget Circular No. A-123 requires Agency action on maintaining viable internal control systems. This circular requires agencies to perform annual vulnerability assessments and internal control reviews. If not taken seriously, internal control weaknesses may not be identified and corrected.

Second, we noted that the Mission had not established procedures to effectively coordinate agriculture investment activities. The Mission funds at least three projects with components that provide financing to the agriculture sector. Each of these projects was managed by a different USAID/Jamaica office with no formal mechanism in place to effectively collect, summarize, and coordinate project outputs. As a result, project benefits may not be fully realized and potential irregularities and abuses may therefore go undetected.

Third, while not explicitly stated in project documents, there was evidence that PL-480 Title II commodity sales revenues were not to be used to increase the production of certain crops which would compete with domestically-produced American commodities, including certain types of vegetables, sugar, cotton, citrus etc. If this is the position of the United States Government, then USAID/Jamaica needs to ensure that these prohibitions are made known to JADF and incorporated into its new investment policy.

Fourth, the review of JADF project files showed that loan recipients may often purchase non-American products and equipment with their loan funds. Although the project presents opportunities to "buy American" the project's authorizing documents do not comment on this matter. JADF and USAID/Jamaica officials said, however, that encouraging clients to "buy American" was a possibility that was worth pursuing. Because opportunities exist an assessment should be made on how best to take advantage of these opportunities.

Fifth, it was reported that it was difficult to account for all of the PL-480 Title II commodities brought in under the project because of problems with the processor's inventory procedures and records, and because of the reporting procedures used for bulk and processed commodity quantities. This situation may not be as important in the future if title to the bulk commodities was transferred at the port of entry to whomever purchases such commodities. In the interim, it is important that effective accountability controls and reporting requirements be established to better ensure against commodity losses and thefts.

Finally, USAID/Jamaica has not fully documented the problems and mistakes it has experienced with the JADF Project, especially as regards the handling of commodities, so that others contemplating similar projects, can benefit. An evaluation of the Project was not scheduled until the end of its third year of operation or about June 1987. Waiting until then may be too late, in that institutional knowledge may be lost, and since it would be too late as well to assist those currently planning such projects. Recent Congressional budget hearings indicate that both AID/Washington and the Congress supported increasing the number of such projects. Without timely feedback, there was less assurance that the mistakes made in this project would not be repeated elsewhere. The Mission Director agreed that a lessons-learned paper would indeed be valuable and stated that one would be prepared. The paper should be prepared as soon as possible to help minimize lost resources and time.

AUDIT OF USAID/JAMAICA
AGRICULTURAL DEVELOPMENT FOUNDATION PROJECT

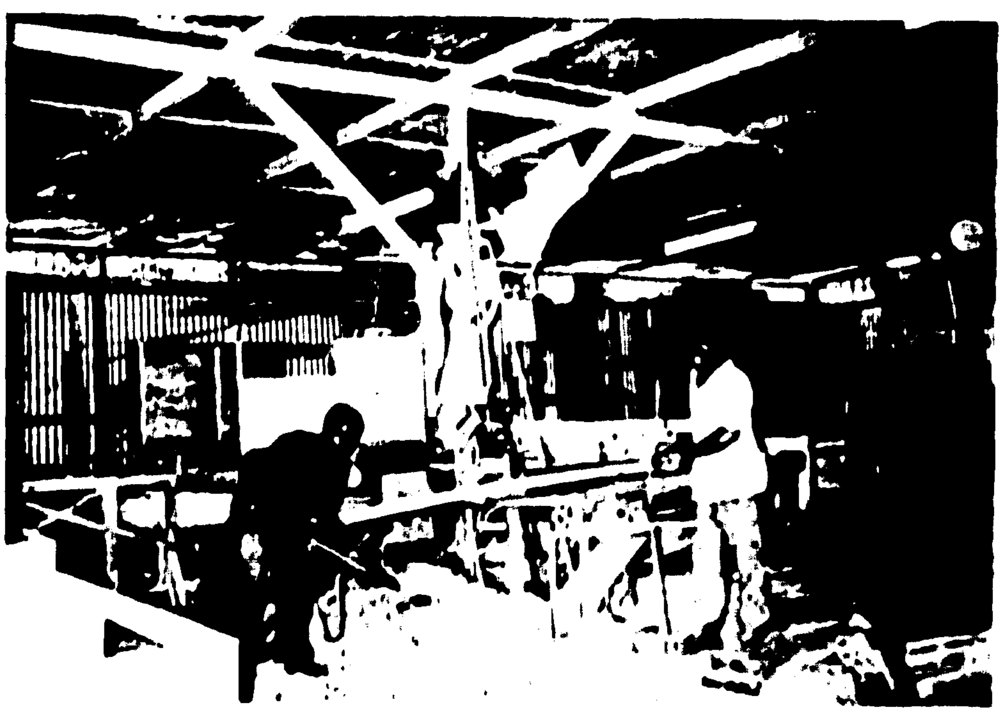
PART III - EXHIBITS AND APPENDICES

AUDIT OF USAID/JAMAICA
AGRICULTURAL DEVELOPMENT FOUNDATION PROJECT

Illustrative Examples of JADF-Funded Projects

Ornamental Horticulture

Woodcraft



Aquaculture

United States Agency for International Development
Mission to Jamaica

6B Oxford Road,
Kingston 5, Jamaica
Tel: 92-94850

MEMORANDUM

June 6, 1986

TO: RIG/A/T:Coinage Gothard

FROM: DIRECTOR:WRJoslin

SUBJ: Draft Audit of USAID/Jamaica Agricultural Development Foundation Project Project No. 532-0105

Enclosed for your review and action is the Mission's response to the subject draft audit report. Per our telephone conversation on Wednesday, June 3, also enclosed is a copy of your draft report with my hand written comments.

The Mission's response to the draft report on the Agricultural Marketing Development Project, No. 532-0060, will be sent via courier early next week. Regret any inconvenience caused by our delay in responding timely to the draft reports.

encl. a/s

USAID/Jamaica Response to
Regional Inspector General Draft Report
On Jamaica Agricultural Development
Foundation Project No. 532-0105

The purpose of this presentation is to provide Mission response to comments and recommendations included in subject audit report. The audit was conducted during the period of January to March 1986, with draft report provided to the Mission in May. Auditors' recommendations are as follows:

Recommendation No. 1

> "We recommend that USAID/Jamaica, in consultation with JADF adjust project objectives and operations in accordance with reduced commodity sale revenues."

A. Discussion

The audit noted that during the 18 month period under review sales of donated butter and cheese have been substantially below original projections. It further states that "USAID/Jamaica and JADF officials had not evaluated the impact of reduced revenues on the program's objectives. Likewise, no assessment had been made of the Foundation's operations to determine if changes are warrented due to income shortfalls".

B. Mission Response

Both JADF and Mission have been aware of the impact of less than anticipated sales of butter. Rather than automatically accept a reduction in projected sales, however, JADF and Mission staff hav worked together to expand butter and cheese markets as well as to investigate the viability of importing alternative commodities to replace whatever shortfall may remain in the sale of butter. The Foundation no longer has an inventory of either butter or cheese; it has sold all previous stocks. JADF is now evaluating whether it should call forward additional supplies of butter in addition to the 1000 MT of cheese scheduled for importation prior to the end of Fiscal Year 1986 (Fiscal-year total 1713 MT). On May 27, 1986, USAID requested a Section 416 grant of wheat, rice and non-fat dry milk with all sales proceeds going to JADF. If this request is approved, USAID will ask that NFDM be regularly provided for JADF's account at an annual level of 2000 MT, yielding US$2,200,000 million. It is evaluating the other commodities for regular supply.

As a result of these new opportunities, it is likely that total revenues for the six year life of the program will approximate original projections in spite of problems encountered in the first 18 months of the project. USAID suggests that the recommendation be recorded as follows:

> "We recommend that USAID/Jamaica, in consultation with JADF take action to either increase the flow of commodity-derived resources to JADF, or adjust project objectives and operations in accordance with reduced commodity sale revenues."

USAID certainly agrees that the audit correctly focuses attention to the problem, but did not give sufficient weight to both sides of the equation. In light of the measures to resolve commodity/revenue problems, USAID feels it is premature to adjust project objectives downward, so has taken action to increase revenues. Attached hereto as Appendix 1 is a current projection of revenues.

Inspector General Comments

Appendix 1 information was considered in finalizing the report, however, it has not been included herewith.

C. Conclusion

Mission believes that amended recommendation should be closed on issuance of the report since action has been taken which will provide revenues sufficient for the project goals to be reasonable. If these efforts are not approved, USAID will formally review program objectives to bring them in line with resource levels.

Recommendation No. 2

"We recommend that USAID/Jamaica, in consultation with JADF:

a. develop an investment/lending policy that (1) accurately reflects the original program investment goals, objectives, and concerns, (2) ensures that resources will be used strictly to finance agricultural activities, and (3) ensures that resources will be used to benefit the small farmer and dairy industry;

b. translate the investment/lending policy into specific but flexible guidelines that, among other things, ensure preferential treatment be accorded small farmers and dairy industry activities by means of lower interest rates, reduced collateral requirements or by other incentives."

A. Discussion

The audit noted that JADF has adopted a policy of investing 25 percent of its funds outside the agricultural sector; made lending decisions based on traditional conservative banking criteria; and not provided financial assistance to the dairy industry.

The audit further states that: "It was understood by program sponsors that the Foundation would be a creative agriculture development organization which would focus on assisting Jamaica's dairy industry and which would take greater risks in investments than practiced by normal lending institutions."

B. Mission Response

In reviewing the JADF loan and equity investment portfolio the audit, as indicated above, commented on the finance criteria of the project as set forth in the First Transfer Authorization. The Authorization also states that "Specifically, the goal of JADF is to help mobilize a new and needed private sector resource base for Jamaica's Agriculture and Agri-business development effort."

The audit targeted three loan/equity situations as being outside the stated purpose of the project i.e., investment in Trafalgar Development Bank (TDB) an AID financed institution which is not primarily focused on agriculture, and two projects devoted to woodcraft and parquet flooring. Both of these decisions were fully discussed at JADF Board Meetings. Although the equity investment in TDB may seem to be outside the scope of JADF activities, it was the opinion of the Board of JADF that Trafalgar's funding could be melded with JADF's when financing in excess of JADF's capacity was required. Given Trafalgar's limited capacity to evaluate such agricultural activities, it was felt that JADF's involvement on the Trafalgar Board would be helpful in this process. Several potential joint projects have been evaluated, though none have been financed to date. Trafalgar has, however, made sizeable loans in agriculture. With regard to the woodcraft and parquet flooring projects, these are normally considered to be agro-industry, in that a finished product is produced from an agricultural product. This point was discussed thoroughly by the JADF Board. The projects in question produce foreign exchange, provide or expand employment, and otherwise meet the goals as stated in the First Transfer Authorization. Whether or not these projects should also include managing the lumber source was not considered important in the review process. It is reasonable to second guess the decision, and to conclude that further such loans are inappropriate. But it is not a compelling case, either way.

The audit commented in this and other sections that JADF is not devoting its activities to the dairy industry as originally intended. The audit refer to this concept as "Being understood by the program sponsors." As the program sponsors who developed the original concept, Land O'Lakes (LOL) and Grace Kennedy (GK) have a primary interest in the dairy industry the concern is understandable. Referring to the Transfer Authorization as the primary source of project purpose, no specific reference is made of the dairy industry.

The Board of Directors and management are, nevertheless, aware of the importance of the dairy industry. The JADF Managing Director was certainly correct in noting the extent that Government policy constraints have created obstacles for dairy farmers. These constraints, while perhaps serving other purposes, have had a negative effect, and thus helped create a scarcity of viable dairy projects, certainly ones with positive rates of return. JADF is perhaps understandably reluctant to fund those that are not "Easily managable and have a high probability of success" as quoted by the audit from the First Transfer Authorization. After all, a series of loan failures would likely bring audit criticisms as well. As Appendix II we are attaching a report recently prepared by the Planning Institute of Jamaica, which details the effect of government policy constraints on the dairy industry.

Inspector General Comments

Appendix II information was considered in finalizing the report, however, it has not been included herewith.

USAID included dairy industry policy conditions in its PL-480 Title 1 self-help measures in FY 1986. In support of these and GOJ efforts to improve policies, JADF has made a loan to finance a new venture to package non fat dried milk in individual 1 liter packets, (which will be the only source of retail subsidized non fat dried milk under the new policy) which will allow the GOJ to concurrently increase non fat dried milk prices to processors to levels which provide incentives to use fresh whole milk. This series of steps, which JADF is helping to make possible, should be a big step toward making the dairy industry viable. Regardless of the portfolio analysis, the JADF role in this reform implementation shows significant interest in dairy issues.

Inspector General Comments

Deleted - Relates to matter not included in the final report.

The audit comments extensively on the degree of risk that JADF is willing to take in the approval process, further saying that:

1. Project sponsors understood "That the Foundation would be a creative Agricultural Development organization which would focus on assisting Jamaica's dairy industry and which would take greater risks in investments than practiced by normal lending institutions."

2. "Because of divergent views among Board Members as to the risk position..... It is doubtful that some of the high-risk agriculture activities intended to be financed by the project will receive any assistance."

3. "The Credit Manual states that the "Foundation will take more risks and be more creative and flexible than commercial banks or other financial institutions."

A review of the loan portfolio indicates that the degree of risk plus other factors would make most, if not all, of these loans unacceptable to traditional banking institutions. Ultimately, repayment history will be the determining factor as to whether the JADF Board of Directors is too conservative in its lending policy, but it now appears that they are fulfilling both the terms and spirit of the project.

C. Conclusion

Mission believes that this recommendation should be closed, since the JADF is acting in accord with recommendation No. 2. Morever, recent changes in Government policies have had a favorable effect on potential for dairy industry investment. Therefore, the mission is satisfied that JADF Board is acting with the consideration of the risk factor and is otherwise conducting the business of the Foundation properly.

Recommendation No. 3

"We recommend that USAID/Jamaica, in consultation with JADF, amend its Articles of Association to preclude JADF Board Members, or the companies they represent, from directly benefiting from JADF operations and investments."

A. Discussion

On the subject of "conflict of interest" the audit targeted Grace Kennedy, Land O'Lakes, Jamaica Citizens Bank, Grace Kennedy Travel, and JADF's Law Firm as companies that can influence policy and at the same time receive benefits from the Foundation's activities. The audit recommends that the Foundation's Articles of Association be amended.

B. Mission Response

In view of LOL's and GK's role as the primary sponsors of the Project, with LOL funded by AID/W to engage in such activities, all parties involved, including AID/W and the Mission, must have recognized the fact that their participation had at least an element of self interest. That LOL would be in a position to provide technical assistance and that this was included in each grant document would indicate that LOL was expected to (in draft udit terms) "benefit" from the Project, to the extent that upplying technical assistance provides any significant benefit to LOL as company.

The audit also comments on GK's monopoly position as the only processer in Jamaica. While Grace Kennedy and its Chairman are well known for involvement in public spirited activities, no doubt this was one of the factors which generated GK interest in the project. Prior to the establishment of the Foundation, GK's affiliated processing company, Dairy Industries, (DI) was operating at 20% capacity and availability of the JADF commodity would alter that shortfall.

The audit reviewed the (DI) claim against JADF that resulted from the terms of the original processing contract, inferring that DI received a benefit due to GK's representation on the Board of JADF. As the two sides had reached an impasse that would very likely have ended up in arbitration and/or a law suit, and preoccupied of most JADF management time and attention, the Mission established a framework from which management of JADF and GK ultimately negotiated a settlement. The terms of the settlement were presented to the Board of JADF and were approved without participation of GK representatives. The Mission is satisfied that GK employees on the JADF board had no inside influence in the outcome of the claim.

Any out of court settlement of a claim is subject to second guessing; but so too would be a decision to let it drag on with JADF incurring continuing charges for cheese and butter storage, and a substantial risk of commodity spoilage. The draft audit second guesses the settlement without fully stating the situation facing JADF and the Mission, or putting the amount of alleged overpayment in the settlement into context in relation to the risks. The audit allegation is frankly objectionable; it penalizes a problem solving approach in favor of a penny saving dollar wasting approach, i.e., don't make "mistakes" even if you do real damage to a project.

The audit includes comments on the use by JADF of the services of Grace Kennedy Travel, a GK subsidiary, as a benefit derived through representation on the JADF Board. GK Travel is considered one of the more efficient and professional of local travel agencies and, as such, is included on a list of only four such agencies approved by the U.S. Embassy in Jamaica. As the cost of airline tickets is standard throughout the travel business, the Mission does not believe there is evidence of conflict to alter the current procedures.

The fact that the Chairman of the Board of JADF is the Managing Director of Jamaica Citizens Bank (JCB) has also been cited as questionable. However, JADF reports that service provided by JCB is as good or better than that offered by other banks because of this connection. With regard to return on deposits, in determining where to deposit funds, the JADF managing director canvasses at least three banks to determine rates available for the amount of funds he wishes to deposit. Funds are deposited with the bank offering the highest rate for the term required. Generally, JCB has offered the highest rate and when this is the case, funds are deposited with JCB. Thus, market rates of interest are paid on JADF fixed deposits. JCB also offers the added feature that deposits may be withdrawn without penalty prior to maturity date, if necessary. A change in these procedures (which seem to also be good business practice) probably would be detrimental to the best interests of the Foundation.

Comments concerning the requirement that JADF clients must use the Foundations Law firm is, according to the audit, no longer in effect. Therefore, no conflict appears to exist at the present time.

The audit recommended that JADF Secretary of the Board, an employee of GK, be replaced. GK made available their experienced and highly regarded employee as a service to the new Foundation. Certainly, it may be possible to question GK's motives. This has been discussed by JADF management on several occasions; it has been concluded, however, that any information that might be of interest to GK would, technically, be available through another Board Member who is also an employee of a subsidiary of GK. Little practical effect would be accomplished by this change, and it would require familiarizing a new secretary with the Foundation's business.

With regard to the directors of the Foundation, it should be pointed out that Jamaica has a relatively small business community with many interlocking directorships. It would be next to impossible to attract the desired calibre of director for the Foundation if it were necessary to avoid every individual who had, or could have in the future, a connection with a loan proposal or other activity of the Foundation. Experience with JADF indicates that in situations of potential conflict the Director in question does not participate.

Conclusion:

Considering the points raised above and noting that the recommendation is at some variance with the discussion and the advice of the General Counsel of the Council on Foundations, Inc., we suggest the following rewording of the recommendation:

> "We recommend that USAID/Jamaica, in consultation with JADF, amend its Articles of Association to preclude JADF Board

,8

> members, from directly benefiting from JADF investments; and to ensure that they will absent themselves from any consideration of transactions between JADF and themselves or companies they represent; and that in the case of any such transactions or investments there shall be specific recorded determination that the transaction is in JADF's interest or the investment is being made pursuant to JADF policies with full knowledge of the potential conflict."

This would require sound business practices, remedy potential problems, and properly credit the importance of avoiding the appearance of conflict. Any director would be obliged to absent himself from a Board discussion of operational issues which could have the appearance of conflict. If this approach is acceptable, the Mission will recommend to JADF that it promptly take the appropriate steps to implement the recommendation as amended.

Recommendation No. 4

The audit commented extensively on the subject of the US$500,000 reimbursable grant provided to JADF in April 1984, with particular reference to the subsequent amendment which altered the calculation of the rate of exchange to be used at repayment date. It further commented that at the time of review no repayment instructions had been provided to JADF. The audit recommended that the exchange rate amendment be revoked and that JADF be provided with repayment instructions.

A. Mission Reply

The Mission had not provided instructions to JADF regarding payment prior to the auditors' arrival as the original intended recipient of the repayment did not prove to be appropriate. The Mission Director rejected the proposed waiver prior to the end of the audit. The Mission, therefore, reviewed other possible recipients consistent with the agreement with JNIP and JADF. Upon identifying an appropriate recipient, the Mission on June 5, 1986, instructed JADF to repay the disbursed portion of the US$500,000 grant calculated at rate of exchange as required in the amended Grant Agreement. Instructions include the name of the payee, a USAID/Jamaica approved project. The letter transmitting these instructions is apended as Appendix III. The Mission finds no basis for the audit's allegation that AID policy requires one or the other formula, but will reinstate the original formula if required. In fact, the total amount of difference between the original and the amended exchange rate formula is US$248.84. On the other hand, it is obvious that the process used was confusing.

Inspector General Comments
Appendix III information was considered in finalizing the report, however, it has not been included herewith.

B. Conclusion

The identification of all other outstanding reimbursable grants the Mission has been completed. Monitoring compliance has been systematized as part of the Mission's quarterly project review. The most recent comprehensive report is attached as Appendix IV. Thus we request that recommendations No. 4. b, c, d, and e be closed on issue. As to 4a, we believe it should be deleted on principle. If you decide otherwise, however, we will implement promptly on notification as we have already spent at least US$248.84 of time on the issue and cannot afford further investment just to argue the merits.

Inspector General Comments

Appendix IV information was considered in finalizing the report, however, it has not been included herewith.

Recommendation No. 5

The audit indicates that this project has not been adequately monitored, with the result that "Funds which could be used to develop Jamaica's Agricultural sector have been used instead to pay "questionable" Foundation operating expenses, and (2) unnecessary AID Grant funds have not been deobligated.

Auditors comments, in summary, recommended that:

1. Project Manager review project expenditures quarterly to ensure compliance with Project Authorization.

2. Ensure Foundation vehicle use is restricted to business purposes and/or reimbursement required for personal use.

3. Ensure that Foundation discontinues practice of funding entertainment expenses.

4. Reprogram or deobligate funds budgeted for unfilled market specialist position, as well as existinq marketing specialist if position is no longer required.

(5) Review remaining OPG items to determine if budgeted amounts are still justified.

A. Discussion

Under the heading of "Questionable Operating Expenses," the audit pointed to the personal use of Foundation-owned automobiles by staff members. Furthermore, those same staff members have been provided with credit card facilities which apparently are used for business related expenses. Automobile expense for an eight-month period for 5 cars totalled about US$11,900. The audit did not indicate what portion of the cost might be for personal use. Expenses charged to entertainment for the same period was

US$8,700. The audit concluded by saying: "It does not appear that the Foundation's focus is consistent with the project's original intent or that its priorities are in order when it spends more on questionable operating expenses like those than it does on assisting the dairy agricultural sector. One former Foundation Board Director was concerned that the Foundation's operations were not efficient and that management appeared to be 'Empire Building'

B. Mission Reply

It has long been the practice in the Jamaican business community and GOJ parastatals to provide, among other benefits, use of company-owned vehicles. This is a form of compensation that would not be subject to Jamaica's inordinately high income tax. These benefits are negotiated as part of the overall benefit and salary package, in lieu of additional salary. Thus, they cannot be evaluated as additional to the salary, but as part of the overall compensation plan. The Foundation must use commonly-accepted inducements to attract qualified staff.

As concerns the use of a limited amount of Foundation funds for business related entertainment expense, the Managing Directors' position is clearly representational. Used with discretion, benefits are to be derived from use of JADF operating funds in furtherance of the goals of the Foundation. Neither of these uses contravene any regulation or guidance which the Mission is aware of regarding use of funds initially generated from monitized commodities.

With reference to the audit's comment regarding the Foundation's "focus," it should be noted that whether the automobile and entertainment expenses are appropriate, there is no apparent relationship to whether or not the dairy industry is receiving the proper consideration.

With regard to the audit's comments concerning the current $1,000,000 Operational Program Grant, the Mission has begun a review of specific budget items to ensure that the utilization of funds is maximized for project objectives. Any excess will be reprogrammed or deobligated.

In addition to questioning the need for a second Marketing Officer, the audit queried the need for the existing Marketing Officer since the terms of the processing agreement provided a fee to DI to perform that function. In this regard it should be noted that the marketing officer was hired several months after the expiration of the contract, thus, there was no overlap. He was hired because there was a need to seek out markets other than those supplied by DI. Indeed, USAID has urged JADF to develop markets in addition to DI. This fact may not have been made clear. This officer has filled a very important function especially in negotiating the sale of excess inventory. With recent changes in the U.S. Farm Bill, new surplus commodities may be available to the Foundation, and it is expected that the marketing officer will be directly involved in these new opportunities.

The Mission has noted audit comments concerning project management responsibility with particular reference to the office within the Mission that is currently holding that responsibility. The Mission has reviewed this structure, as well as the location of PL-480 issues in the Program Office. USAID has requested AID/W concurrence to establish a Food For Peace position in the Office of Agriculture, transferring those functions from Program. If this is approved, JADF will also be reviewed. At this time the work load in Agriculture prevents such a transfer of JADF regardless of its desirability. This is an unfortunate fact of ever reduced ceilings on direct line positions.

Conclusion

The Mission Director has implemented Recommendation 5a (see Appendix V). As to 5b and c, there do not appear to be specific AID regulations prohibiting either the personal use of company

Inspector General Comments
Appendix V information was considered in finalizing the report, however, it has not been included herewith.

owned automobiles or the use of Foundation funds for representational purposes. Nonetheless, the Mission will continue to review these expenditures to ensure that they are limited in amount and contributing to the ultimate goals of the Foundation. The Mission will also ask the JADF to review these procedures for the same purpose. We request that they not be prohibited, i.e., that the recommendationss be deleted.

Recommendations 5d and e are included in 5f, and should be deleted; we have begun the review specified in 5(f), and will complete it as promptly as possible. We will forward the results as soon as the review is completed.

Auditors' Recommendation No. 6

The audit commented extensively on the inventory of butter that existed at the time of inspection. The Mission has taken note of comments and recommendations. The fact is that on April 11, 1986, JADF sold all remaining butter to DI, following USAID insistence that the matter be resolved. Decisive action was taken. Since all inventories of bulk commodity have been sold there appears to be little need for further discussion except to note that new procedures have now been established that will prevent a recurrence of inventory buildup. It should be noted, however, that the Marketing Officer whose position was criticized arranged the sale of butter inventories. In doing so, the excess supply of butter in the market has been depleted. JADF expects to call forward 200 tons of butter prior to the end of the fiscal year, as soon as arrangements are finalized for sale ex-ship.

The audit also commented on the Usual Marketing Requirement (UMR) which seemed to create the necessity for the commercial importation of butter to ensure compliance with the UMR. Although DI was the purchaser of record, this purchase was carried as a liability on the records of JADF. Since the date of the inspection, all of the butter in question has been sold. The JADF liability was liquidated without use of any JADF funds.

Conclusion

The Mission believes this recommendation should be closed in its entirety. USAID steps to identify additional commodities were described earlier. This situation, as commented on by the auditors, no longer exists and the necessary steps have been taken to ensure there is no recurrence.

Compliance and Internal Controls

Under the heading of "Compliance and Internal Controls" the audit made several comments concerning the Reimbursable Grant and the lending activities of the Foundation. These concerns have been discussed elsewhere and are not repeated here.

The Mission has taken note of matters discussed under the heading of Other Pertinent Matters including the following:

1. With regard to the annual vulnerability assessment, present Mission management strongly endorses the vulnerability assessment. In fact, we have an outside team in Kingston right now reviewing vulnerability concerns in three offices.

2. Coordination of agricultural investment activities; insofar as it is accurate to say that three different activities are managed by three different offices within the Mission, coordination is accomplished through quarterly and semi-annual project reviews, as well as a project committee approach to issues. Mission proposed relocation of PL-480 issues was described earlier.

3. Accountability controls as they concern

commodities in the possession of the processor is no longer an issue given the total switch to bulk processing arrangements.

4. A "Lessons Learned" document to record for institutional purposes the problems and mistakes encountered with the JADF has been prepared and is appended as [Annex 5] Appendix VI.

Doc. #0303P

MEMORANDUM

TO : DIR:WJoslin

May 12, 1986

FROM: OPDS:Bruce Heatly

SUBJ: JADF "Lessons Learned" Analysis

As requested I am attaching an analysis of the JADF Project and the lessons to be learned from the problems that developed from the date of Project conception. The analysis is perhaps more detailed than might be necessary if it were to be solely an internal document, but in the event it should be made available to AID/W or other Missions the background summary may prove to be helpful.

Clearances:
OPDS:EKadunc
DDIR:JSchlotthauer

May 27, 1986

JAMAICA AGRICULTURAL DEVELOPMENT FOUNDATION PROJECT NO. 532-0105 - LESSONS LEARNED

In view of the actions taken over the past several months it would seem to be appropriate at this time to determine what lessons may have been learned from the problems that arose in the implementation of this project. The project, as originally conceived, was innovative and, as such, could be expected to develop unanticipated problems. With the benefit of experience and hindsight it is now possible to review the project and to pinpoint those areas that could have been dealt with differently. This should be beneficial for management of the project in the future and may be of assistance to AID/W and other USAID when contemplating the establishment of similar programs.

I. Background

In August of 1982, Land O'Lakes (LOL) was provided a matching grant by USAID/W, "To fund a joint effort directed at overseas cooperative development on a direct cooperative to cooperative basis to be funded jointly by LOL, American Cooperative Development International (ACDI), and AID on a cost sharing basis." Under the terms of the grant it was stated that a particular area for exploration may be the use of PL-480 commodities to develop new investments, introduce new products, and develop new markets as a basis for new agricultural production. A concept paper was prepared by LOL in which they recommended that a Foundation be formed by LOL and Grace Kennedy (GK) to receive, process, and market PL-480 donated butter and cheese.

After consultation with Mission personnel LOL and GK prepared a joint presentation which resulted in further grant financing to LOL by AID/W in the amount of US$56,824 and by USAID/Jamaica in local currency equivalent of US$49,808 (J$144,500) to finance initial technical assistance costs. With the assistance of this grant the Jamaica Agricultural Development Foundation was established on January 5, 1984, with the purpose of importing surplus butter and cheese for commercial sale, and utilizing the proceeds generated from these sales to provide development assistance to the agricultural sector through loans, grants, and equity investments. The commodities were available under the Section 416 dairy donation program. Due to difficulties in securing approval for monetization under Section 416, however, they were (and continue to be) provided through PL480 Title II.

In order to meet start-up costs and operating expenses, pending the arrival and sale of commodity, a "Reimbursable Grant" for US$500,000 was extended to the Foundation. The period of the grant was March 1, 1984, to December 31, 1985.

In August of 1984, JADF entered into a one year contract with Dairy Industries Jamaica Ltd. (DIJL) for the latter to process the bulk commodity on a cost-plus basis with JADF to receive all proceeds of the sale of processed product. This "value-added" concept was developed to ensure maximum returns to JADF. The contract expired in August of 1985, and an interim agreement was in place through December of 1985. Subsequent sales have been handled on a bulk basis without JADF participation in the processing operations.

In determining the amount of commodity to be imported under the program, it was necessary to ensure that normal market forces in Jamaica were not disrupted by the importation of substantial amounts of donated butter and cheese. In order to do so, the "Usual Marketing Requirement (UMR)" was established. The UMR for a given year is the average of commercial importation of a given commodity over the previous five years. As long as the UMR was met by private commercial importation, the donated commodity would not be considered to have caused market disruption.

In accordance with the terms of the first Transfer Authorization (TA), 2000 MT of cheese and 2000 MT of butter were called forward in July 1984, for arrival in Jamaica by September 30, 1984, the end of the fiscal year (FY). During FY 1985, an additional 688 MT of cheese were imported to be blended with older cheese in inventory. For fiscal year 1986, 710 MT of cheese have been imported, and it is anticipated that a further 1000 MT will be shipped prior to September 30. No importation of butter for FY 1986 is anticipated due to substantial inventories of bulk butter at DIJL.

In August of 1985, a further grant of US$1,000,000 was approved for JADF to provide funds for technical assistance, purchase of capital equipment, and to meet additional staff expense in connection with expanded activity of the Foundation. To date, US$133,000 has been drawn against this grant.

II. <u>Project Implementation Problems</u>

The presentation at the local level for the funding of JADF in June of 1983 was a joint effort of Land O'Lakes (LOL) and Grace Kennedy (GK). Although the presentation included extensive information relative to the Jamaican economy, PL-480 program, development impact of the project, etc., it is now clear that it did not have sufficient information to determine consumer demand for the commodities to be imported. The only direct reference to consumer demand is a statistical table for cheese and butter imports for 1969 - 1980. These figures indicate a peak of 5667 MT of butter in 1971, declining to 90 MT in 1980. (Similar statistics were available for cheese imports.) The rapid decline was attributed principally to the lack of foreign exchange, but was also affected somewhat by a drop in domestic purchasing power. On this basis, the assumption was made that demand in 1984 would absorb 2090 MT of butter compared to 90 MT in 1980 and 3073 tons of cheese compared to 1073 tons for the same year. Apparently no statistics were available, nor were estimates made for consumption of cheese and butter in 1981 and 1982. (It is interesting to note that when butter disappeared from the markets it appears that margarine replaced butter in most Jamaican households and the reappearance of competitively priced butter did not cause a substantial return to butter.) Thus, the first major problem encountered by JADF regarded lack of any but very cursory attention to estimates of capacity of the market to absorb these quantities of product after four years or more of scarcities.

Based on this presentation, a joint effort of LOL and GK, the project moved forward, and the Mission provided LOL with a grant of J$144,500 (US$49,808) and a matching grant of US$56,824 provided by AID/W. These grants provided LOL with funds for technical assistance in establishing the Foundation.

During this period it was determined by the advisory group, made up of representatives of LOL, GK, and local businessmen, in consultation with AID, that the contract to process the donated commodity be put out to bid and advertised in the local newspaper.

In an effort to maximize contributions to the endowment of JADF, it was determined that greater profits could be generated by taking advantage of the "value added" from processing the raw commodity. The consensus was that bulk sales to the processor would not provide the greatest financial benefit to JADF. The processing contract, therefore, would state that JADF would provide the processor with the commodity, reimburse the processor for <u>estimated</u> processing costs plus a profit margin, and receive all proceeds of sales to the wholesale distributors.

Bid specifications set forth a number of other requirements as well, the most important of which was the capacity to process a specific amount of commodity within a specific time period. The only company with the capacity to meet these requirements was DIJL, an affiliate of GK and operated by GK under a management contract. The other major shareholder in DIJL was the New Zealand Dairy Board (NZDB), traditionally the major supplier of cheese and butter to Jamaica for whom DIJL processed cheese and butter imported from New Zealand. As DIJL's was the only bid to be made on the processing contract, it was accepted. Thus, a second major problem resulted from attempting to competitively bid the contract when it should have been clear that there was only one established company capable of successfully bidding. This company's close affiliation with GK and NZDB would also cause concern to JADF board members in the future.

The processing contract between JADF and DIJL was negotiated by the interim manager of JADF, a foreign, short-term advisor supported by the Mission grant, and representatives of GK/DIJL. It is unclear as to the extent to which either Mission personnel or advisory committee members participated in the preparation and/or approval of the contract, although at least the Mission project officer reviewed the document. Subsequent events, however, indicate that the terms and conditions of this contract were direct causes of the major problems that developed over the life of the contract.

As an integral part of the contract with DIJL, auditors estimated the cost of processing each ton of commodity plus a profit margin of 20%. The contract also stipulated that at the termination of the contract the <u>actual</u> costs of processing the commodity would be calculated and the necessary adjustments made, depending upon the extent to which the various components of the costs were under or over the estimates. No limitations were placed on potential cost overruns or the 20% profit margin to be applied to these overruns.

Another important clause in the contract required the processor to maintain an average production schedule which, if not met, would presumably allow the Foundation to take corrective action.

Based on these assumptions, 2000 MT of cheese and 2000 MT of butter were called forward during the period from July to September of 1984 under the terms of the first Transfer Authorization. It is unclear as to why the entire amount was imported in such a short period in view of incomplete consumer demand analysis. Apparently Mission personnel were under the impression that if the entire amount authorized in the first Transfer Authorization was not called forward by the end of fiscal year 1984 it would be lost to the Foundation.

The importation of excess commodity resulted in substantial unsold inventories of butter and cheese which created considerable confusion as to potential commodity deterioration and generated substantial storage costs and additional processing costs. These costs, and the possible loss of significant amounts of commodity would, of course, be reflected in reduced inflows to the Foundation.

The original processing contract was allowed to expire and the resulting end of contract claim from DIJL reflected substantial cost overruns. Although specified production levels were not achieved by the processor, which contributed to overruns, DIJL pointed out several situations that were beyond their control and which prevented them from meeting production requirements. They were of the opinion that the cost of these problems should be shared by all parties concerned especially since, in their view, GK/DIJL were instrumental in the establishment of JADF and considered themselves to be "founding members."

The claim by DIJL was ultimately resolved through negotiations. Commodity sales are now arranged prior to placing the call forward and are covered by a bank guaranty. In addition, commodity is now sold on a bulk basis and JADF is no longer involved in the problems of processing costs, production schedules, and storage expense.

III. Lessons Learned

The above is a brief discussion of the problems that developed in the organization of JADF and the implementation of the AID project. Many of the difficulties encountered in project implementation were the result of decisions that had unforseen repercussions. The decisions themselves cannot be reversed but the resulting problems were possible to resolve. The following is a list of "lessons learned".

Several of the comments are not necessarily pertinent to the Jamaica project but are sufficiently important to include should other Missions develop a project using surplus commodities. It would be important for those Missions to:

1. Participate directly in the organization of the development bank or foundation to be established to operate the program and ensure that any advisory committee set up for the purpose of organizing that institution include representatives of the agriculture and business sectors who have no direct or indirect connection with the processing or distribution of the commodity to be imported.

2. Ensure that adequate market surveys are undertaken to determine consumer demand, such surveys to be performed by an independent market research organization that does not have a vested interest in the project.

3. Make every effort to avoid involvement in the processing of the commodity, especially where such involvement means loss of control of processing and storage costs. While the contract negotiated by JADF was far from perfect, the fact that only one processor existed on the Island, in fact, precluded any competitive advantage. Therefore, the preference should be for sales to be made in bulk quantities, ex-ship, with sales arranged prior to calling forward the commodity and should be governed by an appropriate bank guaranty/letter of credit. Sales ex-ship will avoid excessive storage expense and a bank guaranty will ensure timely payment, which will, in turn, facilitate a smooth flow of funds to the lending institution.

4. Ensure that personnel assigned to manage the project understand the inter-relationships of the various U.S. government departments and agencies involved in the allocation and distribution of surplus commodities. This would include the implications of UMR, the procedures for locating and shipping of commodity, etc. It is essential that communications between the Mission and Washington are such that the project will operate smoothly.

5. Participate in the establishment of lending policies and procedures to ensure that the developmental function of the institution achieves the goals for which the project was designed. Policy guidelines at JADF are not, as yet completely defined although discussions continue on the Board level.

6. Monitor the project more closely than might be the case for more conventional projects due to the innovative use of donated surplus commodity. Close monitoring, at least in the early stages, is also necessary to ensure procedures for financial reporting, for the benefit of JADF Directors and AID, are meaningful and well established.

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7. Ensure that situations in which all AID supported institutions entering into a contractual arrangement with a third party, that each participant retains their own independent legal counsel to ensure that potential areas of conflict are identified and that appropriate measures for resolving such conflict are firmly established in all legal documentation.

Clearance:
OPDS:EKadunc (In draft)
OPEP:JJones
MCashman (In draft)

Drafted:OPDS:BHeatly:edt:4/8/86:0222P

LIST OF REPORT RECOMMENDATIONS

Recommendation No. 1

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation, either (i) obtain a written commitment for additional funding sources which will ensure sufficient revenues to achieve original project goals or (ii) issue a Project Implementation Letter, or its equivalent, to adjust project objectives and operations in accordance with reduced commodity sale revenues.

Recommendation No. 2

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation:

a. develop an investment/lending policy that (i) accurately reflects the original program investment goals, objectives and concerns, (ii) ensures that resources will be used strictly to finance agriculture activities, and (iii) ensures that resources will be used to benefit the small farmer and dairy industry; and

b. translate the investment/lending policy into specific but flexible guidelines that give preferential treatment to small farmers and dairy industry activities by means of lower interest rates, reduced collateral requirements or other incentives.

Recommendation No. 3

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation, amend the Foundation's Articles of Association to preclude Foundation Board members from directly benefiting from Foundation investments; and to ensure that they will absent themselves from any consideration of transactions between the Foundation and themselves or companies they represent; and that in the case of any such transactions or investments there shall be specific recorded determinations that the transaction is in the Foundation's interest or the investment is being made pursuant to Foundation policies with full knowledge of the potential conflict.

Recommendation No. 4

We recommend that USAID/Jamaica:

a. revoke the November 8, 1984 amendment to the April 26, 1984 grant agreement, and require that reimbursement be made as originally prescribed in Attachment 1, Section E (2) of the agreement;

b. issue written instructions to the Jamaica Agricultural Development Foundation requesting reimbursement in full of the funds disbursed;

c. designate a USAID/Jamaica approved project which is to be the recipient of the reimbursable grant and, if no such entity can be designated, advise the Foundation that repayment be made directly to the Mission;

d. review the Mission's portfolio for other reimbursable grants and ensure that recoveries be made in accordance with their funding authorization; and

e. establish Mission accountability controls to ensure that current and future reimbursable grants are properly prepared, monitored and managed.

Recommendation No. 5

We recommend that USAID/Jamaica:

a. require the Jamaica Agricultural Development Foundation Project Manager to review project expenditures quarterly to ensure that project revenues and grant funds are being used in accordance with their funding source authorizations;

b. request AID's General Counsel for an opinion as to the appropriateness of funding entertainment expenses and subsidizing the private use of project vehicles from funds generated from the sale of PL 480 Title II commodities and to take appropriate action based on the opinion;

c. reprogram or deobligate grant funds budgeted for the unfilled marketing specialist position;

d. evaluate the continued need for the existing full-time marketing specialist and, if this position is no longer required, reprogram or deobligate the remaining budgeted funds; and

e. review the remaining Operational Program Grant line items to determine if the budgeted amounts are still justified under current conditions and, if not, make appropriate adjustments.

Recommendation No. 6

We recommend that USAID/Jamaica, in consultation with the Jamaica Agricultural Development Foundation:

a. analyze each of the butter marketing options, as presented by the Mission's Commodity Specialist, and take decisive action on those which can be justified under PL 480 Title II legislation and which result in a significant reduction in inventory levels;

b. request, in the interim, that the contracted food processor and other parties involved with storing the butter accept the equivalent dollar amount in butter in lieu of dollar payment to cover storage and other related costs; and

c. delay calling forward any more butter until existing inventories have been disposed of or committed, and until an advance sales agreement has been arranged.

APPENDIX 3

REPORT DISTRIBUTION

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