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SN-60743

AUDIT OF
THE SMALL FARMERS COFFEE
IMPROVEMENT PROJECT MANAGED BY
THE HONDURAN INSTITUTE OF COFFEE (IHCAFE)
USAID/HONDURAS PROJECT NO. 522-0176

Audit Report No. 1-522-89-31-N
March 29, 1989

AGENCY FOR INTERNATIONAL DEVELOPMENT

U. S. MAILING ADDRESS :
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OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

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March 29, 1989

MEMORANDUM

TO : D/USAID/Honduras, John A. Sanbrailo

FROM : RIG/A/T, ^{3/2} Coinage N. Gothard, Jr. *W. B. O.*

SUBJECT: Audit Report No. 1-522-89-31-N, "Audit of the Small Farmers Coffee Improvement Project Managed by the Honduran Institute of Coffee (IHCAFE)"

This report presents the results of a non-Federal financial audit requested by your Mission of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No. 522-0176, managed by the Honduran Institute of Coffee (IHCAFE). The certified public accounting firm of Price Waterhouse prepared the report, which is dated March 13, 1989.

The purpose of this audit was to report on (1) the fairness of the fund accountability statement of the project for the period January 1, 1985 to December 31, 1987, (2) the system of internal control, and (3) compliance by IHCAFE with applicable laws, regulations, and agreement terms.

In the opinion of Price Waterhouse, the fund accountability statement presents fairly the project's receipts and expenditures for the period January 1, 1985 to December 31, 1987, except that the Government of Honduras and IHCAFE did not contribute the total amount of counterpart funds provided for in the approved budget. Price Waterhouse's study and evaluation of IHCAFE's internal controls related to the project revealed conditions which they believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the fund accountability statement may occur and not be detected within a timely period. The weaknesses observed were (1) inadequate procedures to control the use of loans for intended purposes, (2) lack of specific procedures to control delinquent loan payments, (3) lack of an accounting system procedures manual, (4) project accounting records not kept current and not reconciled with USAID/Honduras records, (5) an inadequate filing system for supporting documentation, and (6) lack of a plan to adequately use the project's microcomputers. In the opinion of Price Waterhouse, IHCAFE complied with applicable laws, regulations, and agreement terms tested, except that the counterpart

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funds contributed were less than budgeted in the agreement and some vehicles acquired with project funds were used for other than project activities. Nothing came to their attention to indicate non-compliance with items not tested. Price Waterhouse identified \$19,000 in questionable costs related to non-compliance with agreement terms.

The Price Waterhouse report contains seven recommendations on internal control and two recommendations on compliance. As a result, the following recommendations will be included in the Office of the Inspector General's audit recommendation follow-up system:

Recommendation No. 1

We recommend that USAID/Honduras obtain evidence from the Honduran Institute of Coffee (IHCAFE) to demonstrate that it has implemented the seven recommendations on internal control and two recommendations on compliance contained in the Price Waterhouse report dated March 13, 1989.

Recommendation No. 2

We recommend that USAID/Honduras negotiate a settlement with the Honduran Institute of Coffee (IHCAFE) concerning the disposition of \$19,000 in costs questioned by the Price Waterhouse report dated March 13, 1989.

The actions already taken by USAID/Honduras and IHCAFE in response to the draft report are sufficient to close recommendation No. 1 upon issuance of this report.

Please advise this office within 30 days of actions planned or taken to implement recommendation No. 2.

INSTITUTO HONDUREÑO DEL CAFE (IHCAFE)
FINANCIAL AND COMPLIANCE AUDIT
OF THE SMALL FARMERS COFFEE
IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT No.522-0176

* * *

MARCH, 1989

INSTITUTO HONDUREÑO DEL CAFE (IHCAFE)
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT NO.522-0176

AUDITOR'S REPORT

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Price Waterhouse

March 13, 1989

Mr. Coinage N. Gothard
Regional Inspector General
for Audit
U.S. Agency for International
Development (A.I.D)
Tegucigalpa, D. C.

Dear Mr. Gothard:

This report presents the results of our audit of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176, managed by the Honduran Institute of Coffee (Instituto Hondureño del Café - IHCAFE) for the years ended December 31, 1985, 1986 and 1987.

BACKGROUND

In May 1981, the U.S. Agency for International Development in Honduras (USAID/Honduras) approved the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176. The project's goals were to strengthen the capability and expand the coverage of the extension service of IHCAFE, and to increase the availability of investment credit for coffee producers in order to mitigate the impact of spreading coffee rust in Honduras.

The borrower/grantee is the Government of Honduras (GOH), which, in turn, granted funds to IHCAFE. Credit funds are administered through tripartite agreements among GOH, IHCAFE, and the Central Bank of Honduras. The funds were made available through the Central Bank to the Banco Nacional de Desarrollo Agrícola (BANADESA), and three private banks: Banco Hondureño del Café (BANHCAFE), Banco de Occidente, S. A., and Banco Sogerin, S. A. These banks would then provide credit to farmers participating in the project. Project funds include the USAID/Honduras loan of US\$16,000,000, the USAID/Honduras grant of US\$4,250,000, and a counterpart contribution of US\$29,002,000. The project includes the following components:

- a) Extension Activity,
- b) Credit Activity,
- c) Coffee Processing Activity

The project completion date was scheduled for May 26, 1990, and the first disbursement was made by USAID/Honduras in May, 1982. As of December 31, 1987, the disbursements made by USAID/Honduras for the project amounted to approximately US\$16,136,606.

IHCAFE was created in December 1970, through Law Decree No.83 of the Honduran National Congress. IHCAFE's principal purposes are to study, promote, guide and supervise coffee growing and commercialization activities in Honduras. IHCAFE has five experimental centers in different parts of the country, and eight regional offices in Santa Bárbara, Santa Rosa de Copán, Yoro, El Paraíso, Comayagua, Marcala, Olancho and San Pedro Sula.

The project is managed by IHCAFE through a special implementing unit under the direction of a project coordinator. Project accounting is processed in Tegucigalpa independently from IHCAFE's accounting records.

AUDIT OBJECTIVES AND SCOPE

We were engaged to conduct a financial and compliance audit of the Small Farmers Coffee Improvement Project for the years ended December 31, 1985, 1986 and 1987. Our audit work included the review of documentation, accounting records, internal accounting controls and procedures of the implementing unit related to the project.

Our audit was performed in accordance with generally accepted auditing standards and the United States Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) and accordingly included such tests as deemed necessary to determine whether:

- 1) The fund accountability statements of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176, fairly present the project's receipts and expenditures from January 1, 1985 to December 31, 1987, in accordance with the terms of the agreements, identifying any costs which were not fully supported with adequate records or which were not allowable under the terms of the agreements.
- 2) The project's internal accounting control is adequate for USAID/Honduras purposes.
- 3) The GOH and IHCAFE complied with applicable laws, regulations and terms of the agreements.

The following major audit procedures were conducted during our work in order to meet the stated audit objectives:

1) Receipts

Confirming directly with USAID/Honduras and the General Treasury of the Government of Honduras the funding provided to IHCAFE during the audited period. We conducted tests to determine if the counterpart funds were provided on a timely basis and in accordance with the agreements and project needs.

2) Credit activity

Confirming the amounts disbursed for credit activity by the participating banks and the Honduran Central Bank, trustee of the credit fund.

Interviewing project beneficiaries on a selective basis to determine if they received economic and technical assistance as specified in the agreements.

Reviewing on a selective basis the credit files of the recipients in the commercial banks participating in the project, to evaluate the control procedures regarding the lending policies and eligibility of project beneficiaries according to the agreements.

Reviewing the current trend of delinquent accounts in the participating banks' portfolio to evaluate if there were conditions that may have adverse effects on the credit activity.

3) Disbursements for extension activity

Reviewing the adequacy of disbursements for extension activities to assure ourselves that they were documented, allowable in accordance with the agreements, and properly recorded and accumulated in the corresponding period.

RESULTS OF AUDIT

Fund Accountability Statements

In our opinion, except that the Government of Honduras and IHCAFE did not contribute the amount of counterpart funds stated in the approved budget of the agreements, the fund accountability statement of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176, managed by IHCAFE, present fairly the project's receipts and expenditures for the years ended December 31, 1985, 1986 and 1987, in accordance with the terms of the agreements. The results of our audit disclosed

questionable costs of L38,000 (US\$19,000) and counterpart contributions that were less than required by approximately L20,610,548 (US\$10,305,294). However, in October 1988, USAID/Honduras and the Government of Honduras agreed that part of this amount up to approximately L13,395,000 (US\$6,697,500) will be contributed from 1988 to 1990.

Internal Controls

Our study and evaluation of the IHCAFE's internal controls related to the project included the following categories of significant internal controls: accounting process, computer system, budgetary controls, procurement system, inventory handling and management, portfolio management, and payrolls. Our study and evaluation was made in accordance with generally accepted auditing standards and the U.S. comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) in order to determine the nature, timing and extent of the auditing procedures necessary to express an opinion on the project's fund accountability statement for the years ended December 31, 1985, 1986 and 1987. Accordingly, we do not express an opinion on system of internal control of IHCAFE taken as a whole or on any of the categories of controls identified above. However, our study and evaluation disclosed the following conditions which we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the fund accountability statement of the project may occur and not be timely detected.

1. Certain loans were not used as intended by the project.
2. There were not procedures specially designed to control increasing delinquency in the loan portfolio.
3. The project lacked an accounting system procedures manual.
4. Project accounting records were not kept current.
5. Project accounting records were not reconciled with USAID/Honduras and IHCAFE's records.
6. The filing system for accounting documents was inadequate.
7. Project microcomputers were not being used according with a formal plan.

Compliance with Terms of the Agreements and Applicable Laws and Regulations

Our study of the terms of the agreements and applicable laws and regulations revealed that IHCAFE complied with the tested terms of the agreements, except for the following:

- 1- Counterpart funds contributed were less than budgeted in the agreements.
- 2- Vehicles acquired with project funds for the extension activities were used for other than project activities without written authorization from USAID/Honduras.

Nothing came to our attention that caused us to believe that untested items were not in compliance with terms of the agreements and applicable laws and regulations.

MANAGEMENT COMMENTS

This report was discussed with IHCAFE and USAID/Honduras representative who generally agreed with its contents and whose comments and observations were taken in consideration and incorporated herein as considered appropriate. Comments from USAID/Honduras on each specific finding are included in the Annex I to this report.

Sincerely,

Price Waterhouse

Price Waterhouse

INSTITUTO HONDUREÑO EL CAFE (IHCAFE)
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT NO.522-0176
FUND ACCOUNTABILITY STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 1985, 1986 AND 1987

AUDITOR'S OPINION

We have performed a financial and compliance audit of the fund accountability statements of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176, managed by the Honduran Institute of Coffee (Instituto Hondureño del Café, IHCAFE) for the years ended December 31, 1985, 1986 and 1987. The audit was made in accordance with generally accepted auditing standards and the United States Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The fund accountability statement of the Small Farmers Coffee Improvement Project as of December 31, 1984 was examined by other independent accountants whose report, dated November 8, 1985, expressed a qualified opinion due to the lack of certain confirmations.

As mentioned in Note 5 to the fund accountability statements, the Government of Honduras and IHCAFE did not contribute the amounts of counterpart funds stated in the approved budget of the agreements. The funds contributed were less than the required amount by L20,610,548. However, in October 1988, USAID/Honduras and the Government of Honduras agreed that part of this amount up to approximately L13,395,000 will be contributed from 1988 to 1990.

In our opinion, except for the matter described in the preceding paragraph, the fund accountability statement of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No.522-0176, managed by IHCAFE present fairly the project's receipts and expenditures for the years ended December 31, 1985, 1986 and 1987 in accordance with the terms of the agreements with the U.S. Agency for International Development.

Price waterhouse

September 28, 1988, except for Note 5, which is as of October 31, 1988.

INSTITUTO HONDUREÑO DEL CAFE

SMALL FARMERS COFFEE IMPROVEMENT PROJECT
 USAID/HONDURAS PROJECT No.522-0176
 FUND ACCOUNTABILITY STATEMENT
 FOR THE YEARS ENDED DECEMBER 31, 1985, 1986 AND 1987
 (Expressed in Lempiras - Note 2)

	RECEIPTS AND DISBURSEMENTS ACCUMULATED AS OF 12/31/84	RECEIPTS AND DISBURSEMENTS FOR THE YEARS ----- 1985 1986 1987 (EXHIBIT II)			RECEIPTS AND DISBURSEMENTS ACCUMULATED AS OF 12/31/87	BUDGET (EXHIBIT I)	QUESTIONABLE COSTS (Note 6)
RECEIPTS:							
Loan - USAID	L12,476,274	L 4,554,857	L2,034,727	L10,063,024	L29,128,882	L28,595,000	
Grant - USAID	922,518	324,519	456,423	1,440,870	3,144,330	6,150,000	
GOH counterpart	4,992,540	7,739,052	6,255,351	3,719,988	22,706,931	44,265,174	
	-----	-----	-----	-----	-----	-----	
TOTAL RECEIPTS	18,391,332	12,618,428	8,746,501	15,223,882	54,980,143	L79,010,174	
DISBURSEMENTS:							
Credit activity (Exhibit IV)	12,787,245	6,920,858	4,248,578	7,784,593	31,741,274	40,348,506	
Coffee Processing activity	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -	7,657,310	
Extension activity							
Personnel	4,185,140	1,619,701	1,923,550	3,404,772	11,133,163	16,201,176	
Technical Assistance	922,518	296,183	456,423	1,228,794	2,903,918	4,730,000	
Training	209,731	194,932	220,801	557,062	1,182,526	2,775,262	L38,000
Demonstration lots	34,461	16,993	4,650	565	56,669	103,314	
Publications	43,806	71,069	56,520	35,498	206,893	458,482	
Vehicles and equipment	670,711	106,259	177,409	1,363,424	2,317,803	2,509,762	
Evaluations and audits	418		75,600	50,609	126,627	350,824	
Farm rehabilitation		45,884	24,045	25,879	95,808	245,000	
Operating costs and others	221,773	194,425	211,949	322,853	951,000	3,630,538	
	-----	-----	-----	-----	-----	-----	
	6,288,558	2,545,446	3,150,947	6,989,456	18,974,407	31,004,358	L38,000
	-----	-----	-----	-----	-----	-----	-----
TOTAL DISBURSEMENTS	19,075,803	9,466,304	7,399,525	14,774,049	50,715,681	L79,010,174	
Excess of receipts over disbursements	(684,471)	3,152,124	1,346,976	449,833	4,264,462		
Loan payable (Note 4)	1,500,000				1,500,000		
Accounts payable (Note 4)	130,036	23,177	116,686	72,367	342,266		
	-----	-----	-----	-----	-----		
		3,175,301	1,463,662	522,200			
Cash balance							
at the beginning of year		945,565	4,120,866	5,584,528			
	-----	-----	-----	-----	-----		
at the end of year (Exhibit III)	L 945,565	L 4,120,866	L5,584,528	L 6,106,728	L 6,106,728		
	=====	=====	=====	=====	=====		

INSTITUTO HONDUREÑO DEL CAFE (IHCAFE)
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT NO.522-0176
NOTES TO THE FUND ACCOUNTABILITY STATEMENT
DECEMBER 31, 1987

NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

The significant accounting policies adopted by IHCAFE to manage the project are summarized as follow:

Basis of accounting

The accrual basis of accounting is used in recording expenses, but receipts are generally recorded as collected.

Fixed assets

Fixed asset acquisitions are charged at cost directly to the project and are not depreciated.

Severance compensation

Severance compensation for employees, accrued according to length of service, may be payable to them in the event of dismissal under the terms of the labor regulations. No definite liability in this respect existed as of December 31, 1987 and it is IHCAFE's policy to consider such severance payments as expenses in the period in which they become payable.

NOTE 2 - EXCHANGE RATE

The records of the project are kept in Honduran lempiras. The official rate of exchange of two lempiras for one United States dollar has remained constant for many years.

NOTE 3 - HISTORY AND OPERATIONS OF THE PROJECT

The Small Farmers Coffee Improvement Project, was created on June 5, 1981 by a project agreement between the Republic of Honduras and the United States Agency for International Development in Honduras (USAID/Honduras). The purpose of the project is to mitigate the impact of coffee rust on small coffee farmers, by assisting them to increase yields.

The project finances:

- a) The improvement and expansion of the Honduran Institute of Coffee's (Instituto Hondureño del Café, IHCAFE) extension services for small coffee farmers.
- b) The establishment and operation of a special credit fund for beneficiaries who will participate in the coffee program with IHCAFE. Project funds are provided by USAID/Honduras through a loan and a grant, and by the Government of Honduras through counterpart contributions.

NOTE 4 - LOAN AND ACCOUNTS PAYABLE

Loan payable

This corresponds to a temporary loan amounting to L1,500,000 received from the Central Bank of Honduras in 1983 for the credit activity. The loan will be repaid by USAID/Honduras with project funds.

Accounts payable

These accounts include amounts due to IHCAFE as follows:

Expenses pending reimbursement from USAID/Honduras	L 342,266
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NOTE 5 - COUNTERPART CONTRIBUTIONS

The Government of Honduras and IHCAFE compute their counterpart contributions for the extension activity by applying the following criteria:

a) Personnel

80% of the IHCAFE Extension Personnel related with the project and 40% of the IHCAFE Administrative Personnel that provide administrative assistance to the project.

b) Operating costs

Fuel is charged based on the consumption of all vehicles assigned to the project.

c) Other costs

Other disbursements are charged when they are incurred.

The above distribution was determined on the basis of estimates made by management for computing its cost sharing.

The counterpart contributions to the credit activity are based on disbursements in cash.

At December 31, 1987 the counterpart contributions calculated as stated above were less than required as follows:

	<u>Modified Budget</u>	<u>Counterpart Contribution</u>	<u>Difference</u>
Credit Activity	L17,348,506	L10,410,834	L 6,937,672 (a)
Extension Activity	20,459,358	13,243,792	7,215,566
Coffee Processing Activity	6,457,310	-o-	6,457,310 (a)
	<u>L44,265,174</u>	<u>L23,654,626</u>	<u>L20,610,548</u>

(a) In October, 1988 USAID/Honduras agreed with the Government of Honduras, that part of the difference up to approximately L13,395,000 will be contributed from 1988 to 1990.

NOTE 6 - QUESTIONABLE COSTS

According to Appendix I, Section B of the project agreement, IHCAFE will finance all operating costs for training activities. However, in 1985 IHCAFE billed the project L38,000 for charges related to the use of the Jesús Aguilar Paz center for training activities.

INSTITUTO HONDURENO DEL CAFE

EXHIBIT I

SMALL FARMERS COFFEE IMPROVEMENT PROJECT

USAID/HONDURAS PROJECT No.522-0176

TOTAL AMOUNTS BUDGETED BY SOURCE

AS OF DECEMBER 31, 1987

(Expressed in Lempiras - Note 2)

CREDIT ACTIVITY	LOAN USAID	GRANT USAID	COUNTERPART FUNDS GCH	TOTAL BUDGET
Credit administration			L 1,420,000	L 1,420,000
Rehabilitation and nurseries	L23,000,000			23,000,000
Crop production			4,000,000	4,000,000
Renovation and nurseries			10,428,506	10,428,506
Diversification			1,500,000	1,500,000
	23,000,000		17,348,506	40,348,506
EXTENSION ACTIVITY				
Personnel			16,201,176	16,201,176
Technical assistance		4,730,000		4,730,000
Training	1,059,540	670,000	1,045,722	2,775,262
Demonstration lots	103,314			103,314
Publications	293,482		165,000	458,482
Vehicles and equipment	2,293,916		215,846	2,509,762
Evaluations and audits	350,824			350,824
Farm rehabilitation	140,000		105,000	245,000
Operating costs and others	153,924	750,000	2,726,614	3,630,538
	4,395,000	6,150,000	20,459,358	31,004,358
COFFEE PROCESSING ACTIVITY				
Renovation	1,000,000			1,000,000
Working capital	200,000			200,000
Administrative Support			750,000	750,000
Coffee purchases			5,707,310	5,707,310
	1,200,000		6,457,310	7,657,310
TOTAL	L28,595,000	L6,150,000	L44,265,174	L79,010,174

INSTITUTO HONDURENO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT No.522-1076

EXTENSION ACTIVITY DISBURSEMENTS BY SOURCE
JANUARY 1, 1985 DECEMBER 31, 1987

(Expressed in Lempiras - Note 2)

YEAR ENDED DECEMBER 31,

	-----1985-----				-----1986-----				-----1987-----			
	LOAN USAID	GRANT USAID	COUNTERPART FUNDS GOH	TOTAL	LOAN USAID	GRANT USAID	COUNTERPART FUNDS GOH	TOTAL	LOAN USAID	GRANT USAID	COUNTERPART FUNDS GOH	TOTAL
Personnel			L1,619,701	L1,619,701			L1,923,550	L1,923,550				
Technical assistance		L296,183		296,183		L456,423		456,423			L3,404,772	L3,404,772
Training	L 75,463		119,469	194,932	L190,513		30,288	220,801	L 387,720	L1,228,794	18,000	1,228,794
Demonstration lots	10,518		6,475	16,993	4,650			4,650	565	151,342		557,052
Publications	41,793		29,276	71,069	56,520			56,520	24,298		11,200	35,498
Vehicles and equipment	38,839	28,336	39,084	106,259	158,087		19,322	177,409	1,347,352		16,072	1,363,424
Evaluations and audits					75,600			75,600	50,609			50,609
Farm rehabilitation	17,133		28,751	45,884	24,045		135,160	24,045	19,421		6,458	25,879
Operating costs and others	2,399		192,026	194,425	76,789			211,949	59,369		263,484	322,853
	L186,145	L324,519	L2,034,782	L2,545,446	L586,204	L456,423	L2,108,320	L3,150,947	L1,889,334	L1,380,136	L3,719,986	L6,989,456
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EXHIBIT III

INSTITUTO HONDURENO DEL CAFE
 SMALL FARMERS COFFEE IMPROVEMENT PROJECT
 USAID/HONDURAS PROJECT No.522-0176
 CASH IN BANKS

(Expressed in Lempiras - Note 2)

	AS OF December 31		
	1985	1986	1987
USAID/Honduras funds	L 211,810	L (1,908)	L 90,348
Central Bank of Honduras Loan (Note 4)	1,727,995	1,650,000	1,650,000
Rediscount funds	2,133,383	3,506,647	3,001,905
Government of Honduras funds	47,678	254,576	1,022,207
	-----	-----	-----
	4,120,866	5,409,315	5,764,460
Pending reimbursements from USAID/Honduras		175,213	342,266
	-----	-----	-----
Total cash in banks	L4,120,866	L5,584,528	L6,106,726
	=====	=====	=====

EXHIBIT IV

INSTITUTO HONDURENO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT No.522-0176
LOANS RECEIVABLE BY SOURCE

(Expressed in Lempiras - Note 2)

	Balances as of December 31,		
	1985	1986	1987
	-----	-----	-----
USAID/Honduras funds	L13,654,807	L13,402,460	L18,857,557
Government of Honduras funds	5,781,291	9,662,998	8,895,367
Rediscount funds		541,223	3,638,350
Revolving funds	272,005	350,000	350,000
	-----	-----	-----
	L19,708,103	L23,956,681	L31,741,274
	=====	=====	=====

Price Waterhouse

INSTITUTO HONDUREÑO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0176
REPORT ON INTERNAL CONTROLS

AUDITOR'S OPINION

We have performed a financial and compliance audit of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No. 522-0176, managed by the Honduran Institute of Coffee (Instituto Hondureño del Café, IHCAFE) for the years ended December 31, 1985, 1986 and 1987 and have issued our report thereon dated September 28, 1988. As part of our examination, we made a study and evaluation of the project's system of internal controls to the extent we considered necessary, in order to evaluate the system as required by generally accepted auditing standards and the standards for financial and compliance audits contained in the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision). The purpose of our study and evaluation was to determine the nature, timing and extent of the auditing procedures necessary to express an opinion on the fund accountability statement of the project. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal control of the project taken as a whole. For the purpose of this report, we have classified the significant internal controls in the following categories: accounting process, computer system, budgetary controls, procurement system, inventory handling and management, portfolio management and payrolls.

Project management is responsible for establishing and maintaining a system of internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the fund accountability statement in accordance with generally accepted accounting principles and applicable regulations and agreement terms. Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

INSTITUTO HONDUREÑO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT No.522-0176
REPORT ON INTERNAL CONTROLS

AUDITOR'S OPINION

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal control of IHCAFE taken as a whole or on any of the categories of controls identified in the first paragraph. However, our study and evaluation disclosed the conditions described in the accompanying findings 1 to 7 which we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the fund accountability statement of the project may occur and not be detected within a timely period.

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in our examination of the fund accountability statement, and this report does not affect our report on the Fund Accountability Statement dated September 28, 1988.

This report is intended solely for the use of IHCAFE and the U.S. Agency for International Development. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

Pricewaterhouse

September 28, 1988.

INSTITUTO HONDUREÑO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT No.522-0176
REPORT ON INTERNAL CONTROLS

AUDIT FINDINGS

1. Certain loans were not used as intended by the project.

Condition:

In a general evaluation of the loan portfolio we observed that the following farmers did not use the loan funds in the manner intended.

<u>NAME</u>	<u>LOCATION</u>	<u>OBSERVATIONS</u>
Miguel Angel Aguilar H.	Santa Bárbara	Loan was used to buy a house.
Jesús Humberto Alvarado	Santa Bárbara	He cultivated only one hectare of two financed.
Maria Cristina Alvarado	Santa Bárbara	She did not use the first disbursement of L5,661 on her land.

Criteria:

The proper end-use of funds is a necessary factor for ensuring the success of credit activity.

Cause:

In first years of the project IHCAFE and participating banks had not develop adequate procedures in this respect.

Effect:

The objectives of the Project's credit activity were not met for these loans.

Recommendation:

USAID/Honduras should require project administration and participating banks to study the possibility of strengthen the loans disbursement procedures in order to minimize the possibility of desviations on the end use of funds.

2. There were not procedures specially designed to control increasing delinquency in the loan portfolio.

Condition:

We noted increasing delinquency in the loan portfolio. As of December 31, 1987, past due accounts in the participating banks were as follows (expressed in thousands):

<u>Banks</u>	<u>Portfolio</u>	<u>Installments Past due</u>	<u>%</u>	<u>End of the First grace</u>
BANADESA	L15,456	L1,595	10	1984
BANHCAFE	7,773	1,273	16	1984
Banco de Occidente	6,812	229*	3	1988

* At the end of April, 1988, the past due amount for Banco de Occidente increased to L800,000 (13% of total loans).

Criteria:

According to the terms of the agreement, the extension activity should include proper supervision of loan amortizations.

Cause:

There was no cooperative actions to control loan payment delinquency. However, in 1987 certain committees were created for this purpose with personnel of IHCAFE and participant banks.

Effect:

A high tendency of delinquency may have adverse effects on the long-term objectives of the credit activity program.

Recommendation:

USAID/Honduras should require the project's administration to reinforce the credit and extension procedures to improve in general the recuperation of the loans with emphasis in those past due.

3. The project lacked an accounting system procedures manual.

Condition:

In our review we observed that the project lacked an accounting procedures manual.

Criteria:

Projects financed by AID should record their operations in accordance with a properly documented and approved accounting system.

Cause:

These procedures were not required by IHCAFE at the beginning of the project.

Effect:

Lack of a well documented accounting system decreases controls over project activity.

Recommendation:

Project management should document its accounting system in a manual which should contain:

- A chart of accounts
- Instructions for using the accounts
- Accounting policies
- Accounting procedures
- Internal accounting controls

4. Project accounting records were not kept current.

Condition:

We observed that project accounting transactions for 1985, 1986 and 1987 were not posted in subsidiary records until July 1988.

Criteria:

Periodic financial and accounting information should be recorded in a timely manner.

Cause:

None was found.

Effect:

Interim financial information could contain undetected deletions and accounting errors.

Recommendation:

USAID/Honduras should require the project's accounting department to maintain current up-to-date accounting records. Transactions should be posted monthly.

5. Project accounting records were not reconciled with USAID/Honduras and IHCAFE's records.

Condition:

As of December 31, 1987, reconciliations of project accounts with USAID/Honduras and IHCAFE's records were not made.

Criteria:

These reconciliations are key in assuring that all project transactions have been recorded in the project records.

Cause:

There was a lack of coordination between project accounting personnel and IHCAFE and USAID/Honduras accounting departments.

Effect:

Several transactions generated by USAID/Honduras had not been recorded in the project's records as of December 31, 1987. Additionally, we detected salary charges received from IHCAFE amounting to L947,000 that were recorded twice in the project records. This error was corrected in the fund accountability statement.

Recommendation:

USAID/Honduras should require IHCAFE and the project's administration to prepare, on a quarterly basis, all reconciliations of accounts between the project, USAID/Honduras and IHCAFE.

6. The filing system for accounting documents was inadequate.

Condition:

We observed that documents supporting disbursements were kept in unlabeled boxes without reference to permit prompt access.

Criteria:

The accounting files should be stored in a manner allowing for easy access to accounting personnel.

Cause:

There was a lack of retrieval experience by accounting personnel.

Effect:

Accounting personnel may expend too much time trying to locate accounting information.

Recommendation:

USAID/Honduras should require IHCAFE to classify and file the project's documentation in an appropriate manner for prompt access.

7. Project microcomputers were not being used according with a formal plan.

Condition:

The project acquired 17 microcomputers to improve its information capabilities. However, there was no formal plan for their use.

Criteria:

Every process of automation must have a corresponding formal implementation plan.

Cause:

There was a lack of appropriate guidelines for implementation.

Effect:

The project was not taking full advantage of its computers.

Recommendations:

USAID/Honduras should require Project administration to develop a formal microcomputer implementation plan, which would provide a detailed description of the project's microcomputer capabilities and capacities. The key information required for such a plan would include applications and tasks, priorities, timing, issues, and responsibility.

Cause:

There was a lack of appropriate guidelines for implementation.

Effect:

The project was not taking full advantage of its computers.

Recommendations:

USAID/Honduras should require Project administration to develop a formal microcomputer implementation plan, which would provide a detailed description of the project's microcomputer capabilities and capacities. The key information required for such a plan would include: applications and tasks, priorities, timing, issues, and responsibility.

Price Waterhouse

INSTITUTO HONDUREÑO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT NO. 522-0176
REPORT ON COMPLIANCE WITH TERMS OF THE AGREEMENT AND
APPLICABLE LAWS AND REGULATIONS

AUDITOR'S OPINION

We have performed a financial and compliance audit of the Small Farmers Coffee Improvement Project, USAID/Honduras Project No. 522-0176, managed by the Honduran Institute of Coffee (Instituto Hondureño del Café, IHCAFE) for the years ended December 31, 1985, 1986 and 1987, and have issued our report thereon dated September 28, 1988 on the fund accountability statement. Our examination included tests of compliance with agreement terms and applicable laws and regulations on the part of IHCAFE as we considered necessary in the circumstances, and as required by the United States Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision).

The management of IHCAFE is responsible for compliance with agreement terms. Such responsibility also extends to compliance with the laws and regulations of Honduras, as they may be applicable to the covenants of the agreement.

We tested transactions and records for the period from January 1, 1985 to December 31, 1987, which included cash receipts, disbursements and reporting to determine the Project's compliance with the terms of the agreement with the U.S. Agency for International Development and applicable laws and regulations. The results of our study indicated that for the items tested, the project complied with the terms of the agreement and applicable laws and regulations, except as described in the accompanying findings No.1 and 2. Nothing came to our attention that caused us to believe that untested items were not in compliance with agreement terms and applicable laws and regulations.

This report is intended solely for the use of IHCAFE and the U.S. Agency for International Development. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

Price Waterhouse

September 28, 1988, except for Finding No.1, which is as of October 31, 1988.

INSTITUTO HONDUREÑO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT NO. 522-0176
REPORT ON COMPLIANCE WITH TERMS OF THE Agreement AND
APPLICABLE LAWS AND REGULATIONS

AUDIT FINDINGS

Counterpart Funds Contributed were less than Budgeted in the Agreement.

Condition:

The counterpart funds contributed to the project were less than required by the terms of the agreement. As of December 31, 1987, the counterpart contributions were as follows:

	<u>Budget</u>	<u>Counterpart funds Contributed</u>	<u>Difference</u>
Extension activity			
Personnel	L16,201,176	L12,080,858	L 4,120,318
Training	755,722	112,351	643,371
Publication	165,000	11,200	153,800
Vehicles and equipment	215,846	179,749	36,097
Operating costs	2,130,696	848,705	1,281,991
Farms rehabilitation	105,000	6,458	98,542
Trading center	290,000		290,000
Contingency and inflation	595,918	4,471	591,447
	<u>20,459,358</u>	<u>13,243,792</u>	<u>7,215,566</u>
Credit activity	<u>17,348,506</u>	<u>10,410,834</u>	<u>6,937,672 (a)</u>
Coffee processing activity	<u>6,457,310</u>	<u>- o -</u>	<u>6,457,310 (a)</u>
	<u>L44,265,174</u>	<u>L23,654,626</u>	<u>L20,610,548</u>

(a) In October 1988, USAID/Honduras agreed with the Government of Honduras that part of this amount up to approximately L13,395,000 will be contributed from 1988 to 1990.

Criteria:

According to the agreement, the Government of Honduras should contribute or cause funds to be contributed to the project on a effective and timely basis.

Cause:

The Government of Honduras has restricted public expenses in all Government agencies.

Effect:

The activities of the project has not decreased due to this fact.

Recommendation:

USAID/Honduras and IHCAFE should review the counterpart budget in order to establish the actual level of fund, required from the Government of Honduras.

2. Vehicles Acquired with Project Funds for the Extension Activities were Used for Other than project Activities Without Written Authorization From USAID/Honduras.

The following vehicles acquired with project funds for extension activities were used by other departments of IHCAFE.

<u>Number of vehicle</u>	<u>Type</u>	<u>Cost</u>	<u>IHCAFE Department</u>
200	Cherokee	L23,566	General Management
213	Ranger	30,367	Maintenance of main office
214	Blazer	30,367	Maintenance of main office
215	Blazer	28,336	Maintenance of main office
217	Blazer	23,980	General Management
221	Ranger	23,980	Roya Broca Program in San Pedro Sula
241	Ranger	23,980	Roya Broca Program South
242	Ranger	23,980	Research department San Pedro Sula
172	Ranger	23,980	Roya Broca Program San Pedro Sula
176	Ranger	23,980	Training Center Jesús Aguilar Paz

Criteria:

Section B.3 of Exhibit II of loan agreement No.522-T-044 establishes that a written authorization from USAID/Honduras is required for situations like those mentioned above.

Cause:

The vehicles were assigned to other departments of IHCAFE which give support to extension activities.

Effect:

This was noncompliance with the loan agreement.

Recommendation:

To use project's vehicles in accordance with the agreement or obtain written authorization from USAID/Honduras for any deviations.

INSTITUTO HONDUREÑO DEL CAFE
SMALL FARMERS COFFEE IMPROVEMENT PROJECT
USAID/HONDURAS PROJECT NO. 522-0176

LIST OF RECOMMENDATION ON INTERNAL ACCOUNTING
CONTROLS AND ON COMPLIANCE WITH THE TERMS OF THE
AGREEMENT AND APPLICABLE LAWS AND REGULATIONS

INTERNAL ACCOUNTING CONTROLS:

RECOMMENDATION 1:

USAID/Honduras should require project administration and participating banks to study the possibility of strengthen the loans disbursement procedures in order to minimize the possibility of desviations on the end use of funds.

RECOMMENDATION 2:

USAID/Honduras should require the project's administration to reinforce the credit and extension procedures to improve in general the recuperation of the loans with emphasis in those past due.

RECOMMENDATION 3:

Project management should document its accounting system in a manual which should contain:

- A chart of accounts
- Instructions for using the accounts
- Accounting policies
- Accounting procedures
- Internal accounting controls

RECOMMENDATION 4:

USAID/Honduras should require the project's accounting department to maintain current up-to-date accounting records. Transaction, should be posted monthly.

RECOMMENDATION 5:

USAID/Honduras should require IHCAFE and the project's administration to prepare, on a monthly basis, all reconciliations of accounts between the project, USAID/Honduras and IHCAFE.

RECOMMENDATION 6:

USAID/Honduras should require IHCAFE to classify and file the project's documentation in an appropriate manner for prompt access.

RECOMMENDATION 8:

USAID/Honduras should require Project administration to develop a formal microcomputer implementation plan, which would provide a detailed description of the projects microcomputer capabilities and capacities. The key information required for such a plan would include: applications and tasks, priorities, timing, issues, and responsibility.

COMPLIANCE WITH THE TERMS OF THE AGREEMENT
AND APPLICABLE LAWS AND REGULATIONS

RECOMMENDATION 1:

USAID/Honduras and IHCAFE should review the counterpart budget in order to establish the actual level of fund, required from the Government of Honduras.

RECOMMENDATION 2:

To use project's vehicles in accordance with the agreement or obtain written authorization from USAID/Honduras for any deviations.

AGENCY FOR INTERNATIONAL DEVELOPMENT
USAID / HONDURAS

March 8, 1989.

Mr. Reynaldo Rodríguez
Price Waterhouse
Tegucigalpa, D.C.

Dear Mr. Rodríguez:

We have reviewed the draft non-federal audit report and generally agree with the recommendations. However, we feel that IHCAFE and the Mission have taken corrective action on some of the recommendations and consider them closed. Following are our comments:

Recommendation No. 1

USAID/Honduras should require the project's administration and participating banks to study the possibility to strengthen the loans disbursements procedures in order to minimize the possibility of deviations on the end-use of funds.

Following are our comments on the three sub-loans:

a) Miguel Angel Aguilar H. was granted a loan in 1985 for L.9,434 of which L.5,027 was disbursed for the two manzanas transplanted. Further disbursements were suspended upon the determination that this client was not following the technical package criteria. This resulted in a deterioration of the lot and the client has no resources to repay. The Recuperation Committee has reviewed this case and recommended this subloan be charged to the banks reserve for bad loans.

b) Jesús Humberto Alvarado was granted a loan in 1982 for L.8,826 of which L.4,836 was disbursed. Payment of L.526 on principal and L.178 of interest was made leaving a loan balance of L.4,310. The client did not follow the technical recommendations as required. Since this client does have the resource base to effect repayment of his loan the Recuperation Committee has recommended that this loan be turned over to the judicial system for collection.

c) María Cristina Alvarado was granted a loan in 1982 for L.9,368 to renovate 2 manzanas but only renovated 1 manzana. Disbursements were suspended and the loan balance stands at L.5,980. The lot was abandoned and Mrs. Alvarado and her husband moved to Tegucigalpa where both are employed. Since they have the capacity to repay, the Recuperation Committee has recommended this loan be turned over to the judicial system for repayment.

We find these three exceptions to be a very small percentage of the more than 9,000 subloans granted. One could expect there could be other instances of a similar nature, given the clientele of this Project and the magnitude of loans. The fact remains that there is no decapitalization of the credit fund since the Central Bank charges participating banks at the time payments become due. The loss, if any, accrues to the participating bank and if legal remedy fails, they have a substantial reserve built into the Project to cover just such contingencies.

With respect to the recommendation, all three cited subloans were granted prior to the issuance of the Manual of Credit Procedures in 1986. With the use of this manual we expect cases of this nature to be eliminated or reduced to a minimum. (See Annex 4.) It is worthy of note that in all three cases subloans disbursements were suspended before the total amount authorized was disbursed. It would not appear to be cost effective to do more than is currently being done. We request the finding be closed because IHCAFE has taken corrective action to minimize the granting of Project funds to ineligible participants.

Recommendation No. 2

USAID/Honduras should require the project administration to reinforce the credit and extensions procedures to improve the recuperation of the loans with emphasis on those past due.

The Mission and IHCAFE feel there are now procedures in place which have improved the recovery of unpaid and over-due loan amounts. Participating banks have formal procedures (see Annex No. 3) which provide for informing periodically delinquent borrowers of amounts due and the steps taken if payments are not made. This includes taking legal action after each case is reviewed by the Project committee. In addition, the Manual on Credit Procedures (Annex No. 4) provides guidelines on managing credits extended to project participants. We believe these documents are helping in maintaining an extremely low delinquent rate (6.42 percent on December 31, 1988) at the commercial bank level. As you know, there has been no decapitalization of the credit fund in the Central Bank. We ask that you indicate the recommendation has been complied with and is now closed.

Recommendation No. 3

Project management should document its accounting system in a manual which should contain:

- A chart of accounts
- Instructions for using the accounts
- Accounting policies
- Accounting procedures
- Internal accounting controls

IHCAFE officials have informed us that only a chart of accounts is available to manage the accounting system. IHCAFE personnel agree the accounting system needs to be improved and are considering contracting a qualified firm to prepare an accounting manual. The Mission has received and is taking action on a request from IHCAFE for assistance to develop the accounting manual.

Recommendation No. 4

USAID/Honduras should require the project's accounting department to maintain current accounting records. Transactions should be posted monthly.

IHCAFE's manual accounting records are now posted through December 31, 1988. The Mission has recommended to IHCAFE to automate the accounting system in order that all financial transactions are posted daily.

Recommendation No. 5

USAID/Honduras should require IHCAFE and the project's administration to prepare, on a quarterly basis, all reconciliations of accounts between the project, USAID/Honduras and IHCAFE.

The Mission has been sending monthly to IHCAFE a list of the disbursements charged to the A.I.D. accounts. The information is posted to IHCAFE's accounting records and subsequently is used to reconcile with the Mission's Project balances. IHCAFE personnel, however, are not reconciling monthly, but at the close of each quarter. IHCAFE accounting personnel have informed us they have reconciled at the close of December 31, 1988 their accounting balances with the Mission's balances. Please indicate the recommendation has been complied with and is closed.

Recommendation No. 6

USAID/Honduras should require IHCAFE to classify and file the project's documentation in an appropriate manner for prompt access.

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IHCAFE has agreed to improve the maintenance of Project records. They will use counterpart funds to bind the records in a permanent binder which will protect and facilitate the access to the documentation.

Recommendation No. 7

USAID/Honduras should require Project administration to develop a formal microcomputer implementation plan, which would provide a detailed description of the projects microcomputer capabilities and capacities. The key information required for such a plan would include: applications and tasks, priorities, timing issues, and responsibility.

In our opinion, the Project's microcomputers are being used to their maximum reasonable capacity. It seemed prudent to obtain the maximum capacity possible from limited resources available to permit IHCAFE to grow into capacity without having to replace hardware each time it was at capacity. IHCAFE has provided a formal implementation plan (Annex 4) showing the Projector's computers are being effectively used. We find this plan to be acceptable and request that this finding be closed.

"COMPLIANCE FINDINGS"

Recommendation No. 1

USAID/Honduras and IHCAFE should review the counterpart budget in order to establish the actual level of funds required from the Government of Honduras.

For your information the Mission considers this to be an outstanding accomplishment under the Project. All output indicators for the Project have been met or are ahead of schedule. We see these savings, which have resulted from efficiencies realized by IHCAFE as a major assistance to the GOH policy to reduce public expenditures. To force disbursements that have not been needed or that are unnecessary to accomplish Project goals, purposes and outputs hardly seems prudent or wise. The fact is that the GOH and IHCAFE have contributed to and supported Project implementation on a timely and effective basis.

Recommendation No. 2

To use project's vehicles in accordance with the agreement or obtain written authorization from USAID/Honduras for any deviations.

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The finding is only partially correct. The three Blazers were assigned to long-term technical assistance employees. When they were no longer safe for field trips they were replaced. These Blazers were then returned to IHCAFE's Motor pool and have been used for short trip requirements of the Institute, thereby freeing other vehicles for the field staff.

Rangers (No. 221, 241, and 172) are used by the roya broca program. It should be remembered that the Project was designed to combat the effects of roya and that the use of these three vehicles is an extension function that includes Project activities. Ranger No. 176, assigned to the Training Center at La Fé is used in support of training for extension agents, paratécnicos and Project beneficiaries. Ranger No. 242, assigned to the research staff in La Fé was substituted for a 4X4 jeep type vehicle which was then assigned to an extension agent. The research staff frequently needs to move materials, plants and inputs which is greatly facilitated in the Ranger pickup as opposed to a jeep type vehicle. Although a separate unit within the Agricultural Division of IHCAFE, the Research Unit is responsible for the extension teck-pack utilized by the Project. Ranger No. 213, is held in maintenance as a substitute for field vehicles in the shop for repair. Cherokee No. 200, is assigned to the General Manager and utilized for field trips. The General Manager's original vehicle, carried over from previous administrations was a Mercedes Benz which could not be utilized for field visits. Although this instance could be construed a questionable call, the on site supervisory visits to extensionists and Project beneficiaries would seem to tilt the balance to extension.

With respect to the recommendation, written authorization will be provided to IHCAFE for the use of vehicles.

Sincerely,


Rafael Zelava
Sub-Contralor

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APPENDIX II

REPORT DISTRIBUTION

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