

PDABB437
67489

AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

OFFICE OF THE AUDITOR GENERAL
AREA AUDITOR GENERAL - LATIN AMERICA

5120308

AUDIT REPORT
USAID/BRAZIL
NORTHEAST AGRICULTURAL MARKETING PROGRAM

For the period of November 8, 1971
through February 28, 1974

Audit Report No. 1-512-74-86
June 19, 1974

COPY No. 12

TABLE OF CONTENTS

	<u>PAGE</u>
FART I - PURPOSE AND SCOPE	1
FART II - BACKGROUND	2
FART III - SUMMARY	5
FART IV - STATEMENT OF FINDINGS AND RECOMMENDATIONS	7
A. CONSTRUCTION (LOAN NO. 512-L-083)	7
1. General	7
2. Cost Overruns	8
3. Priorities	8
4. Maceió Wholesale/Retail Market	9
5. Salvador Wholesale Market	10
6. Fortaleza Wholesale Market	10
7. Recife Wholesale Market	11
B. TECHNICAL ASSISTANCE (LOAN NO. 512-L-084)	12
1. General	12
2. Staffing	13
3. Training	13
4. Equipment	13
5. Market News Services	14
6. Grades and Standards	14
7. Financial Reporting	14
8. Other International Assistance	15
C. GENERAL COMMENTS	16
1. Mission Monitoring	16
2. Financial Status	16

EXHIBITS

EXHIBIT A - DISTRIBUTION OF AUDIT REPORT

Recom #1 *page 9*
" #2 *" 10*
" #3 *" 15*

REPORT ON EXAMINATION

OF

NORTHEAST AGRICULTURAL MARKETING PROGRAM

FOR THE PERIOD NOVEMBER 8, 1971 THROUGH FEBRUARY 28, 1974

PART I - PURPOSE AND SCOPE

The Brazil Residency of the Area Auditor General, Latin America, has performed an initial examination of the USAID/Brazil Northeast agricultural marketing program, consisting of the following two loans:

<u>Loan No.</u>	<u>Loan Title</u>
512-L-083	Northeast Agricultural Marketing
512-L-084	Northeast Agricultural Marketing Technical Assistance

Our examination covered the period from the inception of the loans on November 8, 1971 through February 28, 1974. However, because of certain activities which transpired subsequent to the cutoff date, we performed supplemental follow-up work as we deemed appropriate. The audit was performed intermittently from December 28, 1973 through June 7, 1974.

The primary purposes of this examination were to determine the degree of attainment of the loans' objectives, and the effectiveness of the planning and implementation of the loans. Other purposes were to evaluate the effectiveness of the financial and administrative management of the loans and the degree of compliance with AID policies, regulations, and procedures.

Our examination was made in accordance with generally accepted auditing standards and included such tests of the borrowers' financial records and related loan documents as were considered necessary in the circumstances; discussions with USAID, Government of Brazil (GOB) and other personnel; and field visits to four sites.

Before issuance, this report was reviewed with appropriate USAID officials and their comments were given due consideration.

PART II - BACKGROUND

Except for a few large metropolitan areas, the food distribution system in Brazil has operated in the traditional Latin American fashion which, by and large, is antiquated and inefficient. This is dramatically demonstrated in the poverty stricken North and Northeast section of Brazil.

There, farming is done on small units of land with little or no application of modern methods. Most farm production is taken to collection centers manually or on pack animals and sold to intermediaries who generally sell to truckers for shipment to urban centers. Practically all of the perishable produce entering the urban centers pass through old public wholesale market facilities, where spoilage losses are high, vehicular and human traffic is congested, the operating scale is small and health conditions are substandard. At the retail level most fresh produce is sold through street fairs where scores of small operators sell from individual stalls.

Interest in modernizing the food distribution system emerged early in the last decade when the Northeast Development Agency (SUDENE) and the São Paulo State government commissioned feasibility studies for modern wholesale market facilities for Recife and São Paulo. The São Paulo market was completed in 1966 and the Recife market opened for business in 1968 with only 30 percent of its planned facilities completed.

At the national level, Brazil's Strategic Development Plan (1968-70) incorporated a plan for a nationwide program of construction, equipping and operation of wholesale and mixed wholesale/retail markets in the urban centers, and assembly markets in the major interior collection points. Subsequently, the program was included in the "Goals and Objectives" of the GOB as among the ten top priority programs for the Agriculture Sector over the years 1970 through 1973. The 1970-1973 National Program for modernization of the agricultural market structure was estimated to cost approximately \$100 million, with 40 percent of this allocable to the North and Northeast regions of the country.

Prior involvement of the USAID in food marketing has consisted of technical assistance and grants from funds generated by P.L. 480, Title I sales agreements. This included, starting in 1966, financing the services of U.S. Department of Agriculture specialists in wholesale facilities (two years) and market news services (four years). AID also contracted Michigan State University (MSU) to study and make recommendations for improving food marketing for the Recife area. The MSU study, conducted by a joint task force composed of technicians from SUDENE and staff members of MSU, was published in 1969 and formed

the basis for the USAID's initial review for a possible loan. The USAID also contracted MONTOR, a Brazilian consulting firm, to assist in the data gathering and pre-loan analyses.

In September 1970, the GOB submitted a loan request for AID financing of \$15 million of the \$40 million North/Northeast agricultural market subsector of the National Program. Subsequent to USAID and AID/W reviews and approval, two complementary loan agreements were signed on November 8, 1971. A description of the two loans follows:

Loan No. 512-L-083, Northeast Agricultural Marketing

This loan, in the amount of \$14 million, provides for financing local currency and U.S. dollar costs of goods and services required to construct, operate and equip wholesale food markets and mixed wholesale/retail food markets in urban centers, and produce assembly markets in major interior food collection points. The National Economic Development Bank (ENDE), the borrower, is to provide an additional \$14 million cruzeiro equivalent while the remaining \$12 million cruzeiro equivalent is to be furnished by the states and municipalities. The ENDE and AID funds are to be sub-loaned by ENDE to (i) mixed economy companies (CEASAs)^{1/} which are to construct, own and operate the wholesale, mixed and assembly markets, and (ii) the Brazilian Food Supply Company (COBAL)^{2/} which is to participate in the operation of each of the markets through its ownership of up to 30 percent of the shares. AID financing is not to exceed 50 percent of any eligible market loan.

The wholesale markets are to be located in cities with over 500,000 population while the mixed markets are to be situated in cities with populations between 170,000 to 500,000. The assembly markets are to be located in major interior producing areas.

Loan No. 512-L-084, Northeast Agricultural Marketing
Technical Assistance

This loan to the GOB, in the amount of \$1 million, provides for financing local currency and U.S. dollar costs of technical assistance, training, and equipment needed to improve the operating efficiency of the food distribution systems and the markets constructed in the North and Northeast under the GOB's National Program. More specifically, the loan financing is to (i) improve and expand the market news service, (ii) establish produce classification grades and standards, and (iii) provide special technical expertise and training in wholesale market operations, retail food marketing, and rural urban marketing integration.

1/ A food supply center company comprised of public and private shareholders.

2/ An organization of the Ministry of Agriculture.

The current Terminal Disbursement Date for both loans is December 31, 1976.

The Executive Group for Modernization of Food Supply (GEMAB), under the Ministry of Agriculture, is to provide for the overall planning and coordination of the program and has the primary responsibility for the execution of the technical assistance phase. ENDE is responsible for implementing the construction phase and is the financial and monitoring agent.

PART III - SUMMARY

The disbursement of construction funds has fallen behind the initial proposed schedule due to pre-construction problems. With one exception, construction time schedules are being generally adhered to.

Cost overruns are being encountered at each construction site. Unanticipated cost increases, project revisions, and optimistic original estimates have resulted in the estimates being exceeded by from 20 to 187 percent. The loan proceeds have been applied to a portion of the cost overruns. Because of the construction priorities established, it appears that if this practice continues, there may not be enough funds to reach each of the three levels of the food distribution systems planned (wholesale, wholesale/retail and produce assembly). We have recommended that the Mission request BNDE to develop an alternative plan, subject to Mission approval, for utilization of the remaining funds so that each level of the food distribution system will receive its aliquot share of funding assistance.

As of December 31, 1973, loan funds in the amount of \$4.6 million had funded part of the construction costs of markets in Salvador, Fortaleza and Aracaju. The latter was still under construction at the time of our examination. The other two are operating, but at a lower level of activity than anticipated because of competition of the old markets. In Fortaleza, the old market is being closed by the state. There, additional funds are to be invested by COBAL and the state to enable the CEASA to pay overdue debts. Salvador was operating at 69 percent capacity while competition from the old market continued.

The Mission for a while withheld use of loan proceeds for the Maceió Wholesale/Retail Market until construction problems were given further study. A significant cost overrun and construction difficulties were the result of inadequate soil analysis of the swamp land chosen for construction. Since not all of the recommended corrective work has been accomplished, and is necessary to efficient operation, we have recommended that the Mission withhold further AID participation until all of the construction remedial action has been taken. Also, if some positive action is not taken within 90 days, the Mission should request a refund of funds already paid.

Technical assistance activity also commenced late but the rate of progress presents no problems, though the work related to the assembly markets lacks clear definition because of the lower priority assigned to it. The training program appears to be progressing generally on schedule. Preliminary work for market news services and grades and standards has been completed, and the operating plans are now being drafted.

COBAL's method of accounting for project costs did not permit a line item comparison of budget versus estimate, nor was this type of information available to facilitate Mission monitoring. Accordingly, we have recommended that future quarterly progress reports reflect such a comparison.

In spite of a limited staff, the Mission monitoring activity has enabled it to be aware of technical problems and to follow-up on the necessary remedial activity. This effort has also motivated improved planning by the implementing agencies through evaluation and reviews.

This report contains three recommendations for Mission action.

PART IV - STATEMENT OF FINDINGS AND RECOMMENDATIONS

A. CONSTRUCTION (LOAN NO. 512-L-083)

1. General

As of December 31, 1973, only \$4.6 million of the \$14 million had been disbursed. A 1972 plan of ENDE had projected a utilization of \$8.8 million by the end of 1973. This lag, as explained by ENDE, was the result of pre-construction problems such as:

- The time consuming process of establishing the CEASAs.
- The creation of legal instruments allowing states and municipalities to be shareholders.
- Changes in architectural and engineering design.
- Delays in the selection of market sites.

Construction, once commenced, has generally progressed according to the schedules established except for the market in Maceió, as explained later.

The loan proceeds have been applied as shown in the following table which also includes a comparison of revised actual estimated costs and original estimated costs:

Site	AID Loan Proceeds-US\$	(In Millions)		Original Estimated Cost - Cr\$	Percent of Increase Over Original Estimate
		Revised Actual/ Estimated Cost US\$	Cr\$		
SALVADOR ^{a/}	2.96	8.5	52.0	41.5	25.3%
FORTALEZA ^{a/}	1.20	4.9	30.0	25.0	20.0%
ARACAJU ^{b/} ^{c/}	.43	1.2	7.5	7.5	-
MACEIO ^{b/}	- ^{d/}	2.2	13.5	4.7	187.2%

a/ Wholesale market.

b/ Wholesale/retail market.

c/ Construction not yet complete.

d/ USAID/B had withheld use of loan proceeds until construction problems were resolved. A partial release of US\$243,750 was made in April, 1974, subsequent to the cutoff date of our audit.

2. Cost Overruns

Generally, the cost overruns are the result of unanticipated construction cost increases, project revisions, and optimistic original estimates. These higher costs carry two implications that could affect the future of the program. First, the economic viability of the individual CEASA might be adversely influenced. Second, the aliquot share of the loan proceeds may not reach the three levels of construction activity as originally intended, i.e. wholesale, wholesale/retail and produce assembly.

The matter of economic viability became a matter of concern to the Mission during 1973 and a review study was made. Using the completed and functioning Recife market as a guide, the Mission concluded that in spite of the cost overruns then known, the markets continued to meet the loan prerequisite of economic viability.

3. Priorities

The second possible negative implication is the result of combining the effects of the cost overruns with the construction priorities established. The implementation plan for this program stated that priority would be given to the construction of the wholesale and wholesale/retail markets to clear the largest bottleneck in the system of food distribution. At the time of our review, construction progress by type of market was as follows:

<u>Type of Market</u>	<u>Number Planned</u>	<u>Completed</u>	<u>In Progress</u>	<u>Not Started</u>
Wholesale	4	3	1	-
Wholesale/retail	7	1	3	3
Produce assembly	9	-	-	9

The BNDE annual report of December 31, 1973 discloses that the total estimated cost of 10 of the 11 wholesale and wholesale/retail markets is in excess of \$47 million. The cost of the produce assembly markets will exceed \$12 million. Through February 28, 1974, loan proceeds were used to match BNDE resources to fund the appropriate share of total construction costs, including cost overruns. Subsequently, the Mission Loan Committee established guidelines limiting AID participation in the cost overruns to 20 percent. Even under this latter procedure, it is possible that there will be no AID loan proceeds to assist the financing of the produce assembly markets.

We take no exception to the system of priorities established. However, unless the planned use of the loan proceeds is altered, the loan assistance may not reach a total vertical segment of the food distribution system, but only the terminal link in the system. Though the produce assembly markets may have been assigned a lower priority in the sequence of construction, they appear to retain their importance as an element in the total distribution system which the loan proceeds were to be applied to. Therefore, it appears incumbent upon the implementing agency, ENDE, that the procedure of applying the loan proceeds be altered so that they will reach a total portion of the program, even if it is a smaller one than originally planned. One approach would be to decrease the number of units assisted. Other alternatives would be for the loan proceeds going to each unit not to exceed the original estimates or to reduce the percentage of AID loan participation in each market.

Recommendation No. 1

That the USAID request ENDE to develop an alternative plan, subject to USAID approval, for utilizing the balance of the proceeds of Loan No. 512-L-083 so that all three elements of the food distribution system described in the loan agreement will receive funding assistance.

4. Maceió Wholesale/Retail Market

As indicated previously, the construction cost of the Maceió Wholesale/Retail Market has almost tripled the original estimate. Although ENDE included these costs in requests for reimbursement from loan proceeds, the Mission withheld disbursement until the Mission's Engineering and Natural Resources Office (ENRO) was satisfied that certain construction problems had been given adequate consideration.

The cost overrun and problems are primarily the result of construction difficulties stemming from an inadequate soil analysis of the swamp land chosen as the site before commencing construction. The land surface lies on a thick sub-layer of silty clay. As a result, substantial fill improperly placed has caused subsidence with pronounced surface fissures and convolutions.

Consequently, a simple floor had to be redesigned as a reinforced floor slab supported on piles. Construction costs for this redesigned floor were high because the superstructure had already been completed. A counterweight fill is another needed corrective measure and must be placed on land which is not now owned by the Maceió CEASA. Expropriation of the land (currently a slum) and relocation of the inhabitants will be necessary. The land cost alone for 6,700 square meters will be about Cr\$1 million. (We noted that the original site had 32,500

square meters and was valued at Cr\$760,000). The CEASA, state, or municipality have not yet taken action to effect the land appropriation and relocation of the inhabitants because of the lack of resources. Unfortunately, even when all the remedial action has been taken, the CEASA will have to periodically resurface the paving and occasionally realign the sewer system because of progressive settlement of the surface.

Subsequent to the cutoff date of our audit, the Mission made a partial reimbursement of \$243,750 to HNDE for construction costs. Total reimbursement will be subject to the Loan Committee formula which limits AID participation in excessive cost overruns. However, we note that all of the requisite corrective measures have not yet been effected, i.e., the counterweight fill on adjacent land. Further, there is no present indication that any of the GOB entities are taking action to acquire the needed land. Since future efficient use of the market requires this counterweight fill, we do not believe that the Mission should approve any further reimbursements for this market until all remedial action has been taken. Should no prompt action occur to complete such action, we also believe that AID should not participate in the construction of this market and request a refund of the funds previously advanced.

Recommendation No. 2

That the USAID (i) not approve further reimbursement of any of the construction costs of the Maceió Wholesale/Retail Market until USAID/ENTRO is satisfied that all the necessary construction and site remedial action has been satisfactorily performed; and (ii) request a refund of the \$243,750 previously paid unless there is positive action taken within 90 days to complete the remedial action.

5. Salvador Wholesale Market

The Salvador Wholesale Market is operating at only 69 percent capacity. Competition from the old downtown market is strong because of the 20 mile distance to the new market. The new location has been justified in light of land costs and urban expansion. Unless regulatory measures restrict use of the old market, however, the new market will not soon reach a financial break-even point.

6. Fortaleza Wholesale Market

This CEASA is short of working capital and has overdue debts. There were indications that COBAL and the state government were going to invest the additional needed funds. Strong state regulatory support

will help increase revenue by closing the unsanitary, old market that has continued to handle about 50 percent of the produce.

7. Recife Wholesale Market

Since the date of contracting preceded the loan authorization, the Recife Wholesale Market was ineligible to receive any loan proceeds. Operations commenced about 5 years ago with only about 30 percent of its facilities completed. The operational experience gained has enabled it to serve as a model and source of knowledge for the other CEASAs. Though state and local support has been weak, federal assistance is reported to have been excellent and is continuing.

B. TECHNICAL ASSISTANCE (LOAN NO. 512-L-084)

1. General

Activity commenced in late 1972 and, generally, appears responsive to program objectives and goals. The program is divided into three components: (i) market news services; (ii) produce classification grades and standards; and (iii) special technical expertise and training in wholesale market operations, retail food marketing, and rural/urban food marketing. Most of the activity to date has been to provide assistance to COBAL in implementing an adequate operational system for the newly constructed wholesale markets. The lower priority given the produce assembly markets, coupled with some initial communication problems between COBAL and BNDE, has resulted in delaying the produce assembly markets definition and design.

A revised budget based on more definitive criteria was proposed by COBAL and accepted by the USAID. The Original Plan and the Revised Implementation Plan - 1972/1975 are summarized below:

<u>Activities</u>	<u>Original Plan^{a/}</u>	<u>Per Revised Implementation Plan-1972/5</u>
Market News	\$ 394,000	\$ 161,000
Grades and Standards	182,000	261,500
Special Technical Assistance	424,000	-
Market Facilities	-	117,000
Administration (Logistic support included)	-	378,500
Program Evaluation and Analysis	-	42,000
Contingencies (Training)	-	40,000
	<u>\$1,000,000</u> *****	<u>\$1,000,000</u> *****

a/ Per Capital Assistance Paper.

2. Staffing

Until recently, the U.S. resident staff has consisted of two personnel: the Principal Advisor and the General Advisor. A Wholesale Market Specialist joined the program in October 1973 for a 2-year contract while a Marketing Extension Advisor was scheduled to start in early 1974.

Two U.S. short-term consultants have also contributed to the program in the fields of market news and market information systems, respectively. Two other U.S. consultants were hired on a short-term basis for program evaluation purposes.

Additionally, loan proceeds have been used to support the hiring of seven Brazilians to fill the position of Federal Technical Supervisors at some of the markets.

A 16 man-months consultant schedule is contemplated for 1974 in the areas of packing, grades and standards, policy and organization, marketing extension and planning, handling facilities and equipment, and market news.

3. Training

For the period 1972-1975, COBAL has plans to train a total of 262 people in Brazil and 19 in the U.S. These trainees are to be selected from high level administrators, market supervisors and reporters, radio operators, graders, extensionists and wholesale market management staff.

The training performed to date is equal to the planned quantitative goals. This includes: (i) a 2-week training tour in the U.S. for four high level executives; (ii) training in Brazil for 26 market supervisors and 16 graders; (iii) a U.N. Food and Agriculture Organization seminar for one high level executive; and (iv) a 6-week training course on grades and standards in the U.S. for 19 technicians. Our discussions with officials of the four state CEASAs we visited indicated they are satisfied with the training offered by the program so far, both in the U.S. and in-country.

Although COBAL believes its need for training is not critical at present, it soon will be due to the expected expansion of CEASAs' operations. COBAL's permanent training centers in Recife and Campinas appear to be responsive to this need.

4. Equipment

The definition of equipment to be procured with loan funds is yet to be made. Since most of such equipment will be for the

assembly markets, definition is not possible until such time as conceptual and feasibility studies of such markets are completed by the U.S. Wholesale Market Specialist and properly approved by the parties concerned.

5. Market News Services

This activity has consisted of a review and analysis of the current market news services and has largely been accomplished by two U.S. short-term consultants. The results of their work have enabled COBAL to commence the formulation of a master operational plan and an evaluation mechanism.

6. Grades and Standards

At present, there are no national standards on quality, grading, and packing for fruits and vegetables. Because of regional differences, price quotations are adversely affected. Also there is a lack of expertise for the development of an effective teaching program in this field. Hence, this requires significant training and consulting inputs. A group of nine participants traveled to the U.S. in January 1974 for a 6-week U.S. Department of Agriculture planned program while 40 people are scheduled to receive grading training in 1974 in CEASA's Training Center in Recife. Moreover, two U.S. Grades and Standards short-term consultants are scheduled to assist COBAL in this program in mid-1974.

A review of existing legislation and procedures has been made by COBAL. This review included a nationwide survey of existing commercial grading and packing practices. As a consequence, a grades, standards and packing improvement plan is now in the drafting stage. It aims to: (i) develop farmer/CEASA/consumer ties; (ii) disseminate information on grading procedures; (iii) disseminate information for better harvesting, handling, packing and shipping practices; and (iv) formulate grades, standards and packing policy.

7. Financial Reporting

We found that COBAL was not accumulating project cost data by budget line item to permit an item by item comparison of actual costs with estimated costs shown in the Implementation Plan. As a result, there was no budgetary control to ensure that the operations conformed to the plan. Also, the quarterly reports of COBAL do not include a line item comparison of actual with budgeted costs.

Consequently, we are recommending that these essential control features be incorporated by COBAL.

Recommendation No. 3

That the USAID request COBAL (i) to accumulate project cost data by budget line item, and (ii) to include in the Quarterly Progress Reports quarterly and cumulative statements of actual project costs compared with the budget by line item.

8. Other International Assistance

In 1972, COBAL entered into a contract for a nationwide technical assistance program with a Spanish corporation which is funded by a loan from the Spanish government in the amount of \$2.2 million. The work performed by the Spanish group has been described by COBAL officials as an aid in the technical assistance aspects of the overall Brazilian market program which is not covered under Loan No. 512-L-084. In their view, the Spanish group has filled a more research-oriented role while the U.S. effort has been devoted to operational activity.

There has been some concern, as reflected in the Program Evaluation Report of November 1973, that there could be a possible functional overlapping of effort by the U.S. team and the MERCASA Spanish group. While it could occur, our discussions with both Mission and COBAL officials indicated that efforts are being exerted by COBAL through its technical advisory office to avoid conflicts and duplication.

C. GENERAL COMMENTS

1. Mission Monitoring

Although BNDE is charged with the primary monitoring responsibility in the market construction, a number of site inspections have been performed by the Mission staff. The identification of technical problems and the follow-up of corrective measures were part of these inspections. The Mission monitors directly the technical assistance activity and a joint USAID/COBAL four-man team performed a program evaluation in late 1973. This effort has contributed to the development of more comprehensive plans by the implementing agencies.

2. Financial Status

As of December 31, 1973, the financial status of the loans was as follows:

	<u>Loan Amount</u>	<u>Committed</u>	<u>Disbursed</u>	<u>Un- Disbursed</u>	<u>Un- Committed</u>
Loan No. 512-L-083	\$14,000,000	\$7,000,000	\$4,589,588	\$2,410,412	\$7,000,000
Loan No. 512-L-084	1,000,000	423,499	132,315	291,184	576,501

EXHIBIT A

DISTRIBUTION OF
AUDIT REPORT
No. 1-512-74-86

	<u>COPY No.</u>
Mr. Marvin Weissman, Director, United States Agency for International Development Mission to Brazil	1 - 10
State Department - Inspector General of Foreign Assistance (IGA)	11
State Department - Country Director - Office of Brazil Affairs (ARA-LA/BR)	12
AID/W - Executive Director (ARA-LA/MGT/EX)	13 - 14
AID/W - Office of Audit (AG/AUD)	15 - 18
AID/W - Office of Program Operations (IA/OPNS)	19 - 20
AID/W - Operations Appraisal Staff (AG/OAS)	21
Inspector-in-Charge, Inspections and Investigations Office/LA (AG/IIS/LA) - Miami	22
Office of the Area Auditor General, Latin America (AAG/LA) - Miami	23
Brazil Audit Residency, AAG/LA	24 - 28

NOTE: All audit work papers are attached to COPY No. 24 which is on file in the Brazil Audit Residency Office, AAG/LA.

- - -

. 17-