

PD-ABD-135

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**PRE-AWARD SURVEY OF THE CAPABILITY OF THE
FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS
TO MANAGE THE USAID/HONDURAS
INVESTMENT AND EXPORT DEVELOPMENT PROJECT**

**Audit Report No. 1-522-91-42-N
August 14, 1991**

AGENCY FOR INTERNATIONAL DEVELOPMENT

OFFICE OF THE REGIONAL INSPECTOR GENERAL

AMERICAN EMBASSY

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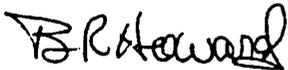
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August 14, 1991

MEMORANDUM

TO: D/USAID/Honduras Acting, B. Loc Eckersley

FROM: RIG/A/T, Reginald Howard 

SUBJECT: Pre-Award Survey of the Capability of the Federation of Agricultural and Agro-Industrial Producers and Exporters of Honduras to Manage the USAID/Honduras Investment and Export Development Project

This report presents the results of a non-Federal pre-award survey of the capability of the Federation of Agricultural and Agro-Industrial Producers and Exporters of Honduras (Federation) to manage the activities of the Investment and Export Development Project, USAID/Honduras Project No. 522-0312. The accounting firm of Arthur Andersen & Co. prepared the report which is dated July 10, 1991. The audit was requested by USAID/Honduras.

The purpose of the project is to increase Honduran non-traditional export earnings and related employment and income. The five year proposed budget is \$10 million, including \$2.5 million in long-term technical assistance and \$1.0 million for a capital fund.

The objectives of the pre-award survey were to report on the Federation's: (1) financial and managerial capability to administer the project, (2) internal control structure with respect to the project's operations, (3) compliance with the terms of the agreement and applicable laws and regulations, and (4) statement of proposed direct and indirect costs.

Arthur Andersen concluded that the Federation has sufficient management capability to manage the activities of the project and to comply with laws, regulations, and proposed agreement terms relevant to the project. The auditors also concluded that the Federation has, except for the lack of an appropriate projection of income, sufficient financial capability to manage the activities of the project. The auditors concluded that the internal control procedures established at the Federation are generally adequate with the exception of four material weaknesses that should be improved in order to strengthen its ability to manage the Project's activities. These weaknesses included: (1) the lack of written

procedures for certain accounting activities, (2) inadequate computer equipment management procedures and a lack of computer capability, (3) commingling of project funds with those of the Federation, and (4) the lack of written reimbursement procedures. In respect to the statement of proposed costs the auditors were not provided the bases, criteria, or documentation supporting the proposed direct and indirect costs and because of this scope limitation did not express an opinion on the project's proposed costs.

This report was discussed with the Federation's management who expressed general agreement with the report. They stated they were in the process of submitting a new proposal with documentation to support the proposed costs and implementing changes to address the findings addressed in the report.

We are including the following recommendations in the Office of the Inspector General's audit recommendation follow-up system:

Recommendation No. 1

We recommend that USAID/Honduras, as a condition precedent to disbursement of funds, require that the Federation of Agricultural and Agro-Industrial Producers and Exporters of Honduras: (1) provide documentation to adequately support its proposed direct and indirect costs for implementing the project, and (2) prepare an appropriate income projection supported by income commitments from the Government of Honduras and other sources expected to contribute resources and establish procedures for the monitoring of the receipt of these resources.

Recommendation No. 2

We recommend that USAID/Honduras require that the Federation of Agricultural and Agro-Industrial Producers and Exporters of Honduras establish a separate bank account and procedures to account for A.I.D. funds separate from its other funds.

Recommendation No. 3

We recommend that USAID/Honduras require the Federation of Agricultural and Agro-Industrial Producers and Exporters of Honduras to demonstrate that it has adequate accounting and administrative procedures manuals to adequately address: (1) monthly closing of accounting records, (2) segregation of cash management functions, (3) management of fixed assets, (4) computer data security, and (5) processing reimbursement requests.

Please advise this office within 30 days of actions planned or taken to resolve and close the recommendations.

PRE-AWARD SURVEY OF
THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS-FPX
TO MANAGE THE INVESTMENT AND EXPORT DEVELOPMENT
PROJECT
USAID/HONDURAS PROJECT No. 522-0312

PRE-AWARD SURVEY OF
THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS-FPX
TO MANAGE THE INVESTMENT AND EXPORT DEVELOPMENT
PROJECT
USAID/HONDURAS PROJECT No. 522-0312

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ARTHUR ANDERSEN & Co.

Guatemala, July 10, 1991

Mr. Reginald Howard
Regional Inspector General for Audit
United States Agency for International Development
Tegucigalpa, Honduras, C. A.

Dear Mr. Howard:

This report presents the results of our pre-award survey of the FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL PRODUCERS AND EXPORTERS OF HONDURAS (FPX) to manage the INVESTMENT AND EXPORT DEVELOPMENT PROJECT USAID/HONDURAS PROJECT No. 522-0312, as of June 21, 1991.

BACKGROUND

The U.S. Agency for International Development, Mission to Honduras (USAID/Honduras), plans to sign a grant agreement with the FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL PRODUCERS AND EXPORTERS OF HONDURAS (Federación de Productores y Exportadores Agropecuarios y Agroindustriales de Honduras-FPX), San Pedro Sula, Honduras to implement the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312. The Project's purpose is to increase non-traditional export earnings and related employment and income. The life-of-project proposed budget is US\$ 10 million over a five year period; this budget includes approximately US \$ 2.5 million in long-term technical assistance and \$ 1 million to a capital fund.

FPX currently receives funds from USAID/Honduras under the Export and Services Project, USAID/HONDURAS PROJECT No. 522-0207.

FPX was constituted for an indefinite term, in January, 1984 under the laws of the Republic of Honduras, as a non profit, private entity. It is located in San Pedro Sula, Honduras. The objective of FPX is to assist and promote the development of the agricultural and agro-industrial exportations of non-traditional products, from the post-crop to their trade. Among the activities performed by FPX are to promote and provide support services to producers and exporters regarding marketing, pricing information on international market, technical assistance and finance.

PRE-AWARD SURVEY OBJECTIVES AND SCOPE

The objectives of our pre-award survey of FPX were to determine whether:

1. The costs proposed by FPX are based on the most complete and accurate pricing data available, and reflect only allowable, allocable and reasonable costs which are considered necessary to accomplish the Project activities.
2. FPX has sufficient management and financial capabilities and span of control to administer the Project, considering its current and future Projects' workload, staffing levels and past performance.
3. FPX's internal control structure, including the control environment, the accounting system, and control procedures; contains sufficient capacity to accurately capture accounting data under the agreement and that the internal controls are adequate for the Project's purpose.
4. FPX is in compliance with applicable laws, regulations and agreement terms.

We conducted our work for the pre-award survey of FPX in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Government Auditing Standards" (1988 Revision).

Our scope of the work included the following steps:

A. Preliminary steps

We reviewed the following documents and applied criteria to the different items tested in performing our work.

1. U.S. Office of Management and Budget (OMB) Circular A-122 "Cost Principles for Nonprofit Organizations".
2. The Mandatory Standard Provisions for Non-U.S., NonGovernmental Grantees.
3. OMB Circular A-110 "Grants and Agreements with Institutions of Higher Education, Hospitals and Nonprofit Organizations"
4. AID Handbook 13, "Grants"

B. Statement of Proposed Costs

1. We have audited the Statement of Proposed Costs and analyzed the criteria used by the company to determine the costs proposed.

2. We assessed that the costs included in the Statement of Proposed Costs were allowable, allocable or reasonable costs.

C. Management and financial capability

In assessing the management and financial capability of FPX, we carried out the following activities:

1. Evaluation of the results obtained by FPX in developing similar projects.
2. Evaluation of the current organization charts and the proposed assignments.
3. Evaluation of the staff levels of capacity in ability and experience terms.
4. Evaluation of the current and proposed work load of the key personnel that would be in charge of the Project.
5. Evaluation of FPX's policies for staff management.
6. Assessment of the procedures followed by FPX for refund requests.
7. Evaluation of whether FPX has the financial capability to cover the Project's proposed expenses during a two-month period, until USAID/HONDURAS provides refunds periodically.
8. Evaluation of FPX's capability to cover its operating costs.
9. Verification of whether there was a formal commitment to obtain the counterpart funds.

D. Internal control structure

We evaluated the current internal control structure and the controls proposed for the Project's management, in accordance with generally accepted auditing standards. The internal controls evaluated included the adequacy of the accounting system, procurement policies and procedures, procedure for contracting technical assistance, planning policies, management and evaluation of the Project, and the output and input procedures in the electronic data processing.

E. Compliance with agreement terms and applicable laws and regulations

Our work in this area consisted of monitoring whether FPX has complied with all applicable laws and regulations and assessing possible risks for the Project, resulting from noncompliance.

Although it was not the purpose of our review, our audit steps and procedures were designed to detect and we were alert to situations or transactions that could indicate fraud, abuse and illegal expenditures and acts.

RESULTS OF SURVEY

In this section we present a summary of the survey results, briefly describing the most significant issues and problems found. These are fully discussed in the corresponding section of this report.

1. Statement of Proposed Costs

We were not provided by FPX with all the bases, criteria and documentation used to estimate the direct and indirect costs for the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT to be managed by FPX during a five year period from 1991 to 1995. There was no sufficient information about the geographical location where the Project is to be developed; therefore, it was not possible for us to verify the reasonability of the increase of hectares being supported; and consequently, the reasonability of the criteria used to prepare the Statement of Proposed Costs. Because of these limitations, the scope of our survey was not sufficient for us to determine whether the related costs were allocable, allowable, reasonable, and necessary for the Project execution, and consequently, we are not in a position to express, and we do not express, an opinion on the Statement of Proposed Costs.

The following conditions precluded us from expressing an opinion:

Amounts included in the Statement of Proposed Costs, considered unreasonable

- In the Statement of Proposed Costs there were some disbursements included that seem to be unreasonable.

Counterpart funds and other income without sufficient bases

- The Statement of Proposed Costs includes US \$ 450,000 which are expected to be received as counterpart funds. As of this date the government has not decided yet on its contributions to this Project in process, and cannot be confirmed by now. There are also revenues for US \$ 799,800 that FPX expects to receive through grants from other entities, but there is no formal commitment from such entities, at the present time.

2. Management capability

We consider that FPX's management capability is satisfactory for the Project's execution.

3. Financial capability

In the Financing Proposal, FPX estimated without sufficient bases that during the next five years, it will obtain income totaling approximately US \$ 842,400 from the interest to be earned through line of credit under the Agreement No. USAID/522-0207.

If FPX does not obtain the income mentioned in the preceding paragraph, we consider that it may have some problems in executing the Project under the expense reimbursement method.

4. Internal control structure

As a result of our evaluation of FPX's internal control structure (different economic cycles), we detected some weaknesses that should be improved in order to strengthen the Project's execution.

Financial Information

- a. Lack of definition of internal controls of cash management, fixed assets, and the monthly accounting closing.
- b. Lack of computer equipment capability and weaknesses in the Electronic Data Processing (EDP) department.

Treasury

- a. FPX funds commingled with Project funds.

Expenditures

- a. Lack of procedures to prepare the requests for reimbursement from USAID/Honduras.
5. Compliance with agreement terms and applicable laws and regulations

The results of our tests indicate that FPX had complied, or was in position to comply, with applicable laws and regulations and proposed agreement terms. With respect to items not tested, nothing came to our attention that caused us to believe that FPX had not complied, in all material respects, with those provisions.

MANAGEMENT COMMENTS:

FPX's management generally agrees with the results of our audit and recommendations; their comments have been incorporated in the report as appropriate. The entire text of the written management comments is included as Appendix I of this report.

Arthur Andersen & Co.

ARTHUR ANDERSEN & Co.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL

PRODUCERS AND EXPORTERS OF HONDURAS-FPX

INVESTMENT AND EXPORT DEVELOPMENT PROJECT

USAID/HONDURAS PROJECT No. 522-0312

STATEMENT OF PROPOSED COSTS

INDEPENDENT AUDITOR'S REPORT

We have reviewed the accompanying Statement of Proposed Costs for the Investment and Exports Development Project, USAID/Honduras project No. 522-0312, to be managed by the Federation of Agricultural and Agro-industrial Producers and Export Development (FPX).

As described in findings from No. 1 to No. 3, it was not possible to evaluate the criteria used by FPX to determine the proposed costs for the Project to be developed; as well as the methodology and data used to prepare the Statement of Proposed Costs for the execution of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT, No. 522-0312.

Due to the limitations described in the preceding paragraph, the scope of our work was not sufficient to express, and we do not express an opinion on the reasonableness, allowability and allocability of the proposed direct and indirect costs for the execution of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT, No. 522-0312.

This report is intended solely for the use of FPX 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.

Arthur Andersen & Co.

June 21, 1991

THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS - FPX
INVESTMENT AND EXPORT DEVELOPMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0312

STATEMENT OF PROPOSED COSTS
FOR THE YEARS 1991 TO 1995

(Expressed in 000' U. S. dollars)

<u>COMPONENT</u>	<u>USAID HONDURAS</u>	<u>F P X</u>	<u>G O H</u>	<u>OTHERS</u>	<u>TOTAL</u>
Agricultural Export Development					
Products development	5,271.0	25.0	0.0	133.8	5,429.8
Products available	1,584.5	0.0	0.0	0.0	1,584.5
Technical Assistance (Long-Term)	1,226.0	25.0	0.0	51.0	1,302.0
Technical Assistance (Short-Term)	28.0	0.0	0.0	7.0	35.0
Training	141.0	0.0	0.0	0.0	141.0
Travel	23.5	0.0	0.0	0.0	23.5
Equipment	268.0	0.0	0.0	0.0	268.0
Research	2,000.0	0.0	0.0	75.8	2,075.8
Market Development	1,502.6	0.0	0.0	636.0	2,138.6
Technical Assistance (Short-Term)	42.0	0.0	0.0	0.0	42.0
Local Area	63.0	0.0	0.0	0.0	63.0
Export Promotion Materials	250.0	0.0	0.0	10.0	260.0
Travel	477.6	0.0	0.0	50.0	527.6
New products tests	320.0	0.0	0.0	50.0	370.0
Overseas offices	240.0	0.0	0.0	426.0	666.0
Promotion investments	75.0	0.0	0.0	100.0	175.0
Training	35.0	0.0	0.0	0.0	35.0
Institutional Development	2,554.0	0.0	0.0	30.0	2,584.0
Technical Assistance (Long-Term)	800.0	0.0	0.0	0.0	800.0
Technical Assistance (Short-Term)	217.0	0.0	0.0	0.0	217.0
Training	87.0	0.0	0.0	0.0	87.0
Equipment	175.0	0.0	0.0	30.0	205.0
Vehicles	275.0	0.0	0.0	0.0	275.0
External debt purchase	1,000.0	0.0	0.0	0.0	1,000.0
Evaluations	310.0	0.0	0.0	0.0	310.0
Local Operation costs	0.0	2,377.7	0.0	0.0	2,377.7
Small Producers Projects	0.0	0.0	450.0	0.0	450.0
Contingent	362.4	0.0	0.0	0.0	362.4
Total	10,000.0	2,402.7	450.0	799.8	13,652.5

ARTHUR ANDERSEN & Co.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL

PRODUCERS AND EXPORTERS OF HONDURAS-FPX

INVESTMENT AND EXPORT DEVELOPMENT PROJECT

USAID/HONDURAS PROJECT No. 522-0312

REPORT ON THE STATEMENT OF PROPOSED COSTS

FINDINGS

1. FPX did not document the criteria related to the Project Proposed Costs nor the basis applied to prepare the pertinent financial data

Conditions

- The cost proposal for Project execution does not describe the basis and criteria applied to prepare the corresponding budget, and we were not given the documentation and other related information.

Criteria

- The cost proposal should be based on the most current, complete and accurate data, which should be available in support of the Project's budget.

Causes

- We were told that the budget for the Project was prepared in conjunction with USAID/Honduras staff and FPX did not receive the documentation on the criteria, basis, assumptions and other information in support of the Project financial data.

Effects

- There is uncertainty as to whether the proposed costs are necessary, reasonable, and applicable for the Project's execution.

Recommendations

- FPX should properly document the proposed costs, by taking into account the eligibility criteria established for such purposes. To this effect FPX should obtain from USAID/Honduras the provision to

which the entity would be subject when managing USAID/Honduras project funds. Also, FPX should submit to USAID/Honduras for its review, the resulting proposed costs prior to USAID/Honduras authorizing the use of Project funds.

2. Amounts included in the Statement of Proposed Costs, considered unreasonable

Conditions

- Within the Statement of Proposed Costs there are included the following accounts that seem to be unreasonable:

<u>C O N C E P T</u>	
Research and development of 4 new products at US \$ 500,000 each one	US \$ 2,000,000
Permanent technical assistance for the Presidency and General Management, during four years (US\$ 200,000 each)	800,000
Contingents	362,400
New products tests	320,000
Two evaluations of the Project during its term (US \$ 155,000 each)	310,000
Purchase of vehicles	275,000
	US \$ 4,067,400

- FPX included in the Statement of Proposed Costs a US \$ 1 million allocated for external debt purchase, in order to generate income for the Federation. However, such transaction was not accepted by USAID/Honduras, and it is unknown where that amount is going to be reassigned.
- FPX prepared the proposed costs for foreign technical assistance based on the maximum rates paid by AID for such a concept. FPX did not contemplate the average paid in previous contracts, which is lower than the proposed costs.

Criteria

- According to the circular OMB A 122, reasonable costs are those that do not exceed the value that a prudent person would incur.

Cause

- Due to the need to submit the financial costs proposal, FPX estimated the proposed costs based upon its criteria instead of documented issues.

Effect

- Proposed costs appear to be overestimated.

Recommendation

- FPX should properly document the proposed costs, by taking into account the eligibility criteria established for such purposes. To this effect FPX should obtain from USAID/Honduras the provisions to which the entity would be subject when managing USAID/Honduras Project funds. Also, FPX should submit to USAID/Honduras for its review, the resulting proposed costs prior to USAID authorizing the use of Project funds.

3. Counterpart funds and other income without sufficient support

Condition

- In the Statement of Proposed Costs there are US \$ 450,000 for counterpart funds from the Government of Honduras, for which there is no assurance whatsoever that FPX will receive.
- In addition, FPX included in the Statement of Proposed Costs other income amounting US \$ 799,800. However, FPX does not have as of this date the confirmation of receiving such income during the Project.

Criteria

- AID requires that there exists a written commitment from the Government of Honduras for obtaining counterpart funds. Also, FPX should establish a procedure to make sure these funds will be timely received.

Cause

- FPX does not have commitment document from the Government of Honduras, to assure that counterpart funds, will be received and there is no formal commitment from other international entities to grant donations.

Effect

- Overestimation of revenues in the Statement of Proposed Costs.

Recommendation

- FPX should request the Government of Honduras the subscription of a commitment document for obtaining counterpart funds. In addition, FPX should establish a procedure to assure that the counterpart funds will be received in a timely manner.

- FPX should obtain a commitment document from other entities for obtaining resources and to establish a procedure to ensure such funds will be timely received.

ARTHUR ANDERSEN & Co.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL

PRODUCERS AND EXPORTERS OF HONDURAS-FPX

INVESTMENT AND EXPORT DEVELOPMENT PROJECT

USAID/HONDURAS PROJECT No. 522-0312

REPORT ON MANAGEMENT CAPABILITY

INDEPENDENT AUDITOR'S REPORT

We have performed a pre-award survey of the Statement of Proposed Costs of the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312, to be managed by THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL PRODUCERS AND EXPORTERS OF HONDURAS (Federación de Productores y Exportadores Agropecuarios y Agroindustriales de Honduras -FPX), and have issued our report dated June 21, 1991, in which we disclaimed our opinion due to significant scope limitations.

As part of the pre-award survey, we have performed an evaluation of FPX's management capability to manage the activities assigned to it under the above mentioned project. Our evaluation included the following areas we consider relevant to the criteria established by USAID/Honduras as set forth in its statement of work for the pre-award survey.

Our survey included the evaluation of the following areas: a) the results obtained by FPX in developing similar projects; b) the current organization charts and proposed assignments; c) the staff levels in relation

to the ability and experience of personnel assigned; d) the current and proposed work load of the key personnel that would be in charge of the Project; and e) FPX's policies for staff management.

Based on our evaluation and understanding of the criteria included in the statement of work referred to in the preceding paragraph, we believe that, FPX has sufficient administrative capability to manage the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312.

This report is intended solely for the use of FPX 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.

Arthur Andersen & Co.

June 21, 1991

ARTHUR ANDERSEN & Co.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS -FPX
INVESTMENT AND EXPORT DEVELOPMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0312

REPORT ON FINANCIAL CAPABILITY
INDEPENDENT AUDITOR'S REPORT

We have performed a pre-award survey of the Statement of Proposed Costs of the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312, to be managed by THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL PRODUCERS AND EXPORTERS OF HONDURAS (Federación de Productores y Exportadores Agropecuarios y Agroindustriales de Honduras - FFX), and have issued our report dated June 21, 1991, in which we disclaimed our opinion due to significant scope limitations.

As part of the pre-award survey, we have performed an evaluation of FFX's financial capability to manage the activities assigned to it under the above mentioned Project. Our evaluation included the following areas we consider relevant to the criteria established by USAID/Honduras as set for in its statement of work for the pre-award survey.

In our survey we performed an evaluation of a) the procedures followed by FFX for fund requests; b) whether FFX has the financial capability

to cover the Project's proposed expenses during a two-month period, until USAID/Honduras provides refunds periodically; c) FFX's capability to cover its operating costs; and d) whether there was a formal commitment to obtain the counterpart funds.

Based on our evaluation and understanding of the criteria included in the statement of work referred to in the precedent paragraph, we believe that, except for the lack of an appropriate projection of income as explained in finding No. 1 of the following page, FFX has sufficient financial capability to manage the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312.

This report is intended solely for the use of FFX 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.

Arthur Andersen & Co.

June 21, 1991

ARTHUR ANDERSEN & Co.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS-FPX
INVESTMENT AND EXPORT DEVELOPMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0312

REPORT ON FINANCIAL CAPABILITY

FINDINGS

1. Uncertainty in obtaining projected proceeds
at the Central Bank of Honduras

Condition

FPX may have problems in covering the project expenses while it receives the USAID/Honduras periodic refunds, because the obtention of the projected US\$ 842,400 is uncertain since FPX estimated such revenues with no basis. Therefore, FPX may have problems with its cash availability.

Criteria

In the Statement of Proposed Costs only the projected revenues based on complete and accurate available information should be included.

Cause

FPX as of this date has no confirmed the funds that expect to receive from the interest earned on the loans given with funds of the Agreement USAID/522-0207.

Effect

The revenues shown on the financial proposal may be overestimated.

Recommendation

FPX must include in the financial proposal only those revenues that are likely to be obtained as interest from the financing line of credit under Agreement USAID/522-0207.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS - FFX
INVESTMENT AND EXPORT DEVELOPMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0312
REPORT ON INTERNAL CONTROL STRUCTURE
INDEPENDENT AUDITOR'S REPORT

We have performed a pre-award survey of the Statement of Proposed Costs of the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312, to be managed by THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL PRODUCERS AND EXPORTERS OF HONDURAS (Federación de Productores y Exportadores Agropecuarios y Agroindustriales de Honduras - FFX), and have issued our report dated June 21, 1991, in which we disclaimed our opinion due to significant scope limitations.

In planning and performing our survey we considered FFX's internal control structure to manage the proposed Project, in order to determine our survey procedures for expressing our opinion on the Statement of Proposed Costs and not to provide assurance on FFX's internal control structure.

The management of FFX is responsible for establishing and maintaining an internal control structure for Project purposes. 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 an internal control structure 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 financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure 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.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories: financial information, procurement, payrolls, treasury, income and conversion.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to

significant weaknesses in the design or operation of the internal control structure that, in our judgment, could adversely affect the Federation's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

Our evaluation of the FPX's internal control structure related to Project activities disclosed the reportable conditions, described as findings No. 1 to 4 on the following pages of this report.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We believe that all reportable conditions described in the following pages as findings 1 to 4 are material weaknesses.

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Arthur Andersen Co.

June 21, 1991

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS-FPX
INVESTMENT AND EXPORT DEVELOPMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0312

INTERNAL CONTROL STRUCTURE

FINDINGS

1. Lack of definition of the
internal controls

Condition

As a result of our evaluation of the FPX's internal control structure, the following weaknesses were detected:

- There was a lack of written procedures to perform monthly accounting closing, which identify among other items, individual responsibilities, critical due dates and accounts that should be reconciled against the subsidiary records.
- There was not adequate segregation of functions in the cash management and accounts receivable areas: the same person that receives and deposits cash in the bank, is the one in charge of handling the subsidiary records of clients from whom the funds are received.
- The subsidiary records of fixed assets are outdated.

Criteria

In an adequate system of internal control, there must be procedures defined in writing for the following activities: a) accounting closing, b) an adequate segregation of functions, c) safeguard of the entity's assets.

Cause

The manual of accounting procedures lacks specific written instructions in regard to the above mentioned areas.

Effect

- Some transactions may not be recorded in the respective period

- The Project funds received may be diverted without noticing it at the proper time.
- There exists the risk of subtracting the fixed assets without timely detection. In addition, there is not assurance of fixed assets existence and physical location.

Recommendation

FPX should include in its accounting manual, the procedures to carry out accounting closing, segregation of functions in cash management, and procedures for controlling the fixed assets.

2. Lack of computer equipment capability and weaknesses in the Electronic Data Processing (EDP) Department

Condition

When assessing input and output procedures in the electronic data processing area, we detected the following weaknesses:

- The computer equipment of the accounting department has a small memory capacity; therefore, it processes the information very slowly.
- The accounting program in use is inflexible.
- Some personal computers have no restrictions on the access to the accounting information.
- The computer equipment is used in an isolated way, that is physical resources are not shared.
- There are master files without protection against non-authorized access.
- There still are access codes to the accounting software that were used by ex-employees of the entity.
- Some accounting reports issued by the EDP department do not appear to be accurate.

Criteria

- The accounting systems (manual or computerized) should provide timely and accurate information.
- Accounting software should be flexible, so that adjustments and/or necessary changes can be made.

- Internal controls in an EDP environment require that any computer equipment has the following features:
 - . Minimal access restrictions (Passwords).
 - . Master files protection against non-authorized access.
 - . Updated access codes.
- The computer equipment operation should be maximized sharing the physical and logical resources, in order to avoid duplicating information.
- Reports issued by any application acquired or developed should be consistent.

Causes

- Lack of computer equipment in accordance with the accounting department needs.
- Inadequate software for accounting purposes.
- Lack of clearly defined policies on access restrictions, master files protection, access codes, and updating.
- Each FPX department handles its own data and programs.

Effect

- Processing of accounting transactions and issuance of reports takes a long time.
- Some accounting transactions are not recorded in the corresponding month.
- Any person can access important accounting information in the computers.
- Any file may be modified or eliminated, without leaving any evidence.
- People who make modifications to the applications may not be identified.
- All personal computers have the same software installed (word processor, electronic sheets), using disk space and complicating the sharing of information.
- The reports issued are not completely reliable.

Recommendations

FPX should consider:

- Evaluating the convenience of acquiring a more flexible accounting software or to modify the one it already has;
- Designing an access procedure for the different software used including total protection against non-authorized access to any software;
- Establishing procedures to assure that access codes are frequently changed and to eliminate the passwords that identify personnel that no longer works for FPX; and
- Integrating all personal computers into a multi-user network in order to share physical and logical resources and to assure the safety and integrity of the information.

3. FPX funds commingled with Project funds

Condition

FPX deposited its own funds together with Project funds received from USAID/Honduras and other sources.

Criteria

The Financial Audit Guide issued by the Controller General of the United States, requires that an entity's own funds not be commingled with loans or grant funds provided by any U. S. Government Agency.

Cause

The bank accounts of Project No. 522-0207 financed by USAID/Honduras, are usually kept with a low amount of funds. This is due to the fact that the reimbursement of expenses by USAID takes a long time. Therefore, FPX has transfer its own funds to the operating account for the execution of the Project.

Effect

In the financial statements of Project USAID/Honduras No. 522-0207 managed by FIDE, there are receivables to the Federation.

Recommendation

FPX should open and maintain a separate account for the management of USAID/Hondurs project funds.

4. Lack of procedures to prepare the requests
for reimbursements from USAID/Honduras

Condition

FPX does not have a written policy defining procedures to prepare requests for reimbursements from USAID/Honduras. This situation has resulted in the requests being prepared according to the FPX's General Accountant criteria.

Criteria

As a part of an adequate control measure, to execute the Projects financed by USAID/Honduras, FPX should have written procedures that result in a timely, accurate, and appropriate presentation of the refunds application.

Cause

There is no policy in the administrative procedures manual for the preparation of request for reimbursements.

Effect

The applications for expenses refunds from USAID/Honduras are backlogged because they are not periodically prepared. At the same time this results in FPX receivables from USAID/Honduras, because the Federation must cover with its own funds the expenses of projects financed by USAID. An example of this situation is FPX receivable from USAID/Honduras of Lps. 1,642,538, as of April 30, 1991.

Recommendation

FPX should define clear policies for the preparation, review, and authorization of requests for reimbursement, and should include those policies in the administrative procedures manual.

FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL
PRODUCERS AND EXPORTERS OF HONDURAS - FPX
INVESTMENT AND EXPORT DEVELOPMENT PROJECT
USAID/HONDURAS PROJECT No. 522-0312
REPORT ON COMPLIANCE WITH AGREEMENT TERMS
AND APPLICABLE LAWS AND REGULATIONS

INDEPENDENT AUDITOR'S REPORT

We have performed a pre-award survey of the Statement of Proposed Costs of the activities of the INVESTMENT AND EXPORT DEVELOPMENT PROJECT, USAID/HONDURAS PROJECT No. 522-0312, to be managed by THE FEDERATION OF AGRICULTURAL AND AGRO-INDUSTRIAL PRODUCERS AND EXPORTERS OF HONDURAS (Federación de Productores y Exportadores Agropecuarios y Agroindustriales de Honduras - FPX), and have issued our report dated June 21, 1991, in which we disclaimed our opinion due to significant scope limitations.

The management of FPX is responsible for compliance with agreement terms and applicable laws and regulations. As part of our review to obtain reasonable assurance about whether the Statement of Proposed Costs is free of material misstatement, we performed tests of FPX's compliance with agreement terms and certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that FPX had complied, or was in position to comply, with applicable laws and regulations and proposed agreement terms. With respect to items not tested, nothing came to our attention that caused us to believe that FPX had not complied, in all material respects, with those provisions.

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Arthur Andersen & Co.

June 21, 1991



MANAGEMENT COMMENTS TO PRE-WARD SURVEY OF FPX TO MANAGE
USAID/HONDURAS PROJECT No. 522-0312

1. STATEMENT OF PROPOSED COSTS

FPX will present within the next 3 weeks to USAID/HONDURAS a new proposal which will take in to account several changes that have occurred since the original submittal of their proposal in December 1990. This new report will fully document the proposed costs and projections. Export and employment goals will be based only on projects supported by FPX.

The December proposal was prepared based on the operating experience of the institution in developing annual plans and the following:

- a) Sectorial studies of the export potential of specific products. e.g. Study of the Shrimp Potential in Honduras developed by Tropical Research and Development.
- b) Product Development Plans (PDP) which are prepared and reviewed annually by the institution for every product they promote. These documents provide sufficient statistical information on exports, and the recommendation was closed.
- c) AID policy to consider maximum costs for technical assistance in the development of proposals.

The issue of obtaining formal commitments from the Government of Honduras (GOH) and other donor entities is an area in which FPX is working on and expects to obtain them in the near future. FPX will require AID support and assistance for the GOH commitments as these will be provided by PL484, Title III funds.

2. FINANCIAL CAPABILITY

The new proposal will include a more detailed analysis of the projected revenues. Specifically, the projected interest spread for the 522-0207 Credit Line will be projected on a loan by loan basis. A formal agreement between AID and the Central Bank of Honduras already exists and remains in force until one or both of the parties decides to modify it.

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3. INTERNAL CONTROL STRUCTURE

FPX has instructed its accounting personnel on the new procedures and segregation of functions for the monthly accounting closing. (See attached memorandums A). The control of fixed assets will be strengthened and new procedures are being developed.

Regarding computer equipment a study was completed in August 1990 to define specific equipment needs (See attached Memorandums B). Accordingly, the necessary equipment has already been purchased (See Attachment C). The multi-user network will be purchased once FPX moves to its new office building during the next months. The current accounting system has been reviewed (See attached Memo D) and further evaluations will take place in the following months to decide whether the current system is modified or substituted by a new one. On July 18, 1991 the passwords and access procedures have been modified (See attached Memorandum E).

As seen in attached example (F) of daily memos, FPX has separate bank accounts by funding source. On July 1 a memo was sent to guarantee that funds are deposited in the appropriate accounts (See attached Memo G).

Regarding the procedure for the preparation, review and authorization of the requests for reimbursements by AID, FPX's new Administrative Manager will travel to AID to verify their procedures and subsequently will develop the appropriate policies and include them in the Administrative Procedure Manual.

July 19, 1991

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