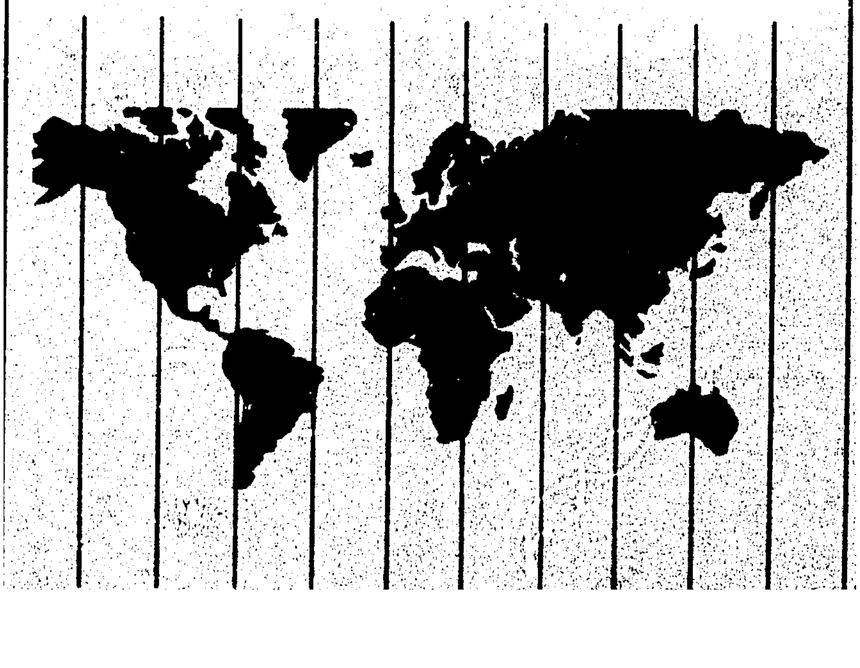
UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE INSPECTOR GENERAL



Regional Inspector General for Audit
TEGUCIGALPA

PD-ABC-164
ISN 69387

AUDIT OF
THE HIGH IMPACT AGRICULTURAL
MARKETING AND PRODUCTION PROJECT
REGIONAL DEVELOPMENT OFFICE/CARIBBEAN
PROJECT NO. 538-0140

AUDIT REPORT NO. 1-538-91-003
NOVEMBER 21, 1990

U. S. MAILING ADDRESS:
RIG/T
APO MIAMI 34022

AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

TELEPHONES:
32-9987 - 32-3120
FAX No. (504) 31-4465

November 21, 1990

MEMORANDUM

TO: RDO/C Director, Aaron Williams

BRHoward

FROM: RIG/A/T, Reginald Howard

SUBJECT: Audit of the High Impact Agricultural Marketing and Production Project, Regional Development Office/Caribbean Project No. 538-0140, Audit Report No. 1-538-91-003

The Office of the Regional Inspector General for Audit/Tegucigalpa has completed its audit of RDO/C's High Impact Agricultural Marketing and Production Project. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment and your comments are attached to this report as Appendix 2. In light of your decision to continue this Project I again express my concern to use the $14.4 million remaining Agency funds on a Project which has accomplished very little in its initial four years of implementation and currently has no future direction, since realistic life-of-project targets and indicators have not yet been developed. In order to assist your Mission in maximizing the use of available resources I plan to conduct a follow-up audit of this Project during fiscal year 1992.

The report contains five recommendations. Recommendations 1.a., 2.a., and 5 are resolved and closed upon issuance of the report. All other recommendations are resolved and can be closed upon our receipt of relevant documentation and/or the completion of the actions planned in your comments to the draft report. Please advise me within 30 days of any additional actions taken to implement the resolved recommendations.

I appreciate the cooperation and courtesy extended to my staff during the audit.

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EXECUTIVE SUMMARY

The Regional Development Office/Caribbean's High Impact Agricultural Marketing and Production Project was authorized on July 15, 1986 and is currently planned to end on July 15, 1993. Its purpose was to increase the agricultural sector's contribution to the region's gross domestic product at a rate of five percent per annum. The project is implemented by the Agricultural Venture Trust, and Eastern Caribbean Agribusiness Development, a U.S. - based contractor. The project was designed to demonstrate attractive returns on equity investments in agricultural businesses. A.I.D. authorizations for the project total $22,727,000. As of September 30, 1989, obligations totaled $14,827,867, accrued expenditures totaled $8,293,301, and advances totaled $893,380. No counterpart contributions were required.

In brief, the results of our audit were as follows:

-- Project accomplishments have been modest to date with only 28 percent of accrued expenditures being used for investments and grants.

-- Commercialization grants were not providing for dissemination of results grant activities to third parties as required by A.I.D. policy.

-- Required environmental protection measures were not always taken.

-- Because several companies and organizations receiving funds under the project have not complied with agreed upon accounting and audit requirements. There is no means of assessing the financial performance of investments made by the Agricultural Venture Trust.

-- Advances to the Agricultural Venture Trust exceeded immediate disbursing needs causing the incurrance of unnecessary borrowing costs of $24,766.

The report contains five recommendations. The Mission concurred with all recommendations and provided their plan to resolve the issues reported. With respect to our finding regarding the Project's accomplishments, however, the Mission took exception to our conclusion that the Project should be terminated. Their comments stated that much of the Project costs were developmental costs, that is the costs associated with establishing a new financing institution. Information was not available during our audit to determine whether costs should be segregated as "developmental" or if they should be, to what extent. Nonetheless, the extent of developmental costs is not germane to the issue of whether the Project should be continued. What is germane, is whether an objective assessment of the Project, reflecting RDO/C's most recent plan to redirect its focus, would show if significant benefits would likely result from continuing the Project. Such assessment has not been made by the Mission as of the date of this report.

The Mission also discussed the investment portfolio and investment trends in their original response dated September 7, 1990 and in an updated response dated November 15, 1990. As our draft report was substantially revised based on the Mission's response and subsequent discussions Appendix 2 includes only those portions of the Mission's original response which address the findings as presented in the final report. Pertinent information provided in the updated response is included in the Management Comments and IG Response section of Finding 1. Upon request RIG/A/T will furnish the entire texts of both responses.

Office of the Inspector General

Office of the Inspector General
November 21, 1990

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PROJECT NO. 538-0140

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AUDIT OF
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PART I - INTRODUCTION

A. Background

The High Impact Agricultural Marketing and Production Project (Project) was authorized on July 15, 1986. While the original project assistance completion date was July 30, 1991, the current planned project assistance completion date is July 15, 1993. The Project purpose is to demonstrate attractive returns on equity investments in agricultural businesses.

The Project was originally conceived as including three major components. The first component, quick response activities, included funding for grants and equity investments in small agricultural businesses. The second component, major subprojects, included funding for four subprojects: regional cocoa, tropical fruits, leewards diversification, and mariculture. The third component, core contractor, included funds for a contractor which would assist in implementing the quick response activities and designing the major subprojects.

The Project was subsequently redesigned twice. The first redesign, completed in June 1988, discontinued the major subprojects component. The second redesign, completed in June 1989, extended the planned project assistance completion date and included other changes to reduce operating costs and improve coordination between the two organizations implementing the Project.

The Project is presently being implemented by two organizations. The first organization, the Agricultural Venture Trust (Trust) is a charitable trust which is responsible for making equity investments in small agribusinesses and grants to nonprofit agricultural organizations. The maximum size of the Trust's investments and grants is $500,000. The Trust receives A.I.D. funds under a grant agreement dated September 29, 1986.

The second organization, Eastern Caribbean Agribusiness Development (Agribusiness Development), is a joint venture between Development Alternatives, Inc. and Western Agri-Management Company. Agribusiness Development is working under a July 20, 1986 contract signed by the Regional Development Office/Caribbean (RDO/C). Agribusiness Development is responsible for identifying investment and grant opportunities and preparing business plans for the Trust's consideration. Agribusiness Development also makes commercialization grants of up to $10,000 each to businesses and individuals wishing to investigate the feasibility of new agricultural activities.

At the time our audit ended, RDO/C's contract with Agribusiness Development was being replaced by a contract between the Trust and Development Alternatives, Inc. This contract had reportedly been signed by both parties but the signed contract had not been returned to the Trust.

A total of $22,727,000 has been authorized for the Project as currently designed. As of September 30, 1989, obligations totaled $14,827,867, accrued expenditures totaled $8,293,301, and advances totaled $893,380 (Exhibit 1).

B. Audit Objectives

The Office of the Regional Inspector General for Audit/Tegucigalpa performed an audit of RDO/C's High Impact Agricultural Marketing and Production Project. The audit objectives were to determine:

1. The extent to which planned results and benefits were being achieved.

2. Whether the Project's exclusion from A I.D.'s environmental procedures was justified.

3. Compliance with audit and accounting requirements.

4. If cash was being advanced to the implementing agency in excess of their immediate needs.

Appendix 1 contains a complete discussion of the scope and methodology for this audit.

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AUDIT OF
THE HIGH IMPACT AGRICULTURAL
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REGIONAL DEVELOPMENT OFFICE/CARIBBEAN
PROJECT No. 538-0140

PART II - RESULTS OF AUDIT

We did not use the Project's original life-of-project targets and indicators to determine whether the Project was achieving planned results because these targets and indicators were no longer applicable or realistic. In order to make this determination we compared operating costs with direct benefits provided under the Project, evaluated the quality of the Trust's investments and grants by calculating rates of return and well-known financial ratios, reviewed past Project activity, and examined RDO/C future projected Project targets. Based on these analyses, we believe that the Project should be terminated.

We also found that environmental protection measures, although required were not always taken. This occurred, in part, because responsibility for enforcing A.I.D.'s environmental protection requirements were passed from RDO/C to the Trust. We believe RDO/C needs to better assure that environmental protection measures are taken.

It should be pointed out that the High Impact Agricultural Marketing and Production Project is an innovative project. In implementing the Project's main activity -- equity investments in small agribusiness companies -- RDO/C could not draw on previous A.I.D. experience as it could have if it were implementing a conventional credit project. RDO/C recognized early that the Project was not operating as planned and has redesigned the Project twice. The most recent redesign, completed in June 1989, included measures to reduce operating costs and improve coordination between the two implementing organizations. Also, at the time our audit ended in April 1990, an International Executive Service Corps volunteer was assisting the Trust in strategic planning and in monitoring its portfolio of investments.

The findings in this report discuss: (1) the Project's results to date, (2) Agribusiness Development's management of the commercialization grant fund, (3) needed environmental protection measures, (4) financial monitoring of investments and grants, and (5) outstanding cash advances to the Trust.

The report recommends that RDO/C: (1) decide whether the Project should be terminated or allowed to continue and, if it is allowed to continue, develop new

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targets and indicators; (2) obtain evidence that Agribusiness Development has adopted standard grant agreements; (3) take actions to improve compliance with environmental protection requirements; (4) obtain evidence that businesses and organizations receiving Project funds are complying with accounting and audit requirements; and (5) recover advances which exceed the Trust's immediate disbursing needs.

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A. Findings and Recommendations

1. Project Accomplishments Were Disappointing

Of the $8.3 million spent as of September 30, 1989 only 28 percent had been used for investments and grants with the rest (72 percent) going for Project expenses. Moreover, at least six of the seven investments made by the implementing agency, for which we had financial information, were to businesses now sustaining losses. The reasons for the lack of accomplishments are difficult to assess. However, we believe the primary reason is due, in large part, to the many difficult and probably insurmountable problems encountered in implementing a project of this type in the Caribbean area considering the nature of business opportunities and the overall economic environment. Given the level of performance thus far against A.I.D./Washington approved targets and fully considering projected future results from the Regional Development Office/Caribbean's recent restructuring of the Project, we believe that continuing with the Project would not represent a good use of the remaining $14 million of Project funds. Most of the $8.3 million expended to date has not resulted in either benefits to A.I.D.'s target population or progress toward Project objectives nor is there clear evidence that this latest restructuring will make the Project economically viable. Accordingly, we believe that the Project should be terminated.

Recommendation No. 1

We recommend that the Regional Development Office/Caribbean:

a. decide whether to terminate the High Impact Agricultural Marketing and Production Project or allow it to continue, and

b. if the Mission decides to allow the Project to continue, prepare a project paper amendment with life-of-project targets and indicators which will justify Project continuation and which can be realistically achieved by the project assistance completion date.

Discussion

The "logical framework" for A.I.D. projects presents the project goal, purpose, outputs, and inputs, as well as objectively verifiable indicators that would show when these were to be achieved. This document is contained in the "project paper" which is reviewed at the A.I.D./Washington level. A project is approved by A.I.D./Washington based on their review of the project paper data and considered opinion that the project's expected results justify use of A.I.D.'s limited resources.

A comparison of the targets included in the current logical framework for the Project and accomplishments as of September 30, 1989 is presented in Exhibit 2. Specifically, the comparison shows 0 to 29 percent of the targets being achieved, while nearly half (44 percent) of the Project life had passed. Significant, however, is that there was little or no achievement towards the accomplishment of the primary target--the "Project purpose"--i.e., increasing the agricultural sector's contribution to the gross domestic product (GDP) by five percent per annum.

Most of the targets and indicators in the original logical framework were no longer applicable or realistic. Consequently we devised other means of evaluating the Project. We compared total Project expenses to the amount of money actually reaching Project beneficiaries in the form of investments and grants. We evaluated the quality of the Trust's investments and grants by calculating rates of return and widely used financial ratios. And, we analyzed data since the beginning of the Project to see whether investments and grants were increasing or decreasing.

The amount of money spent on Project investments and grants has been disproportionately low when compared to total Project expenditures. During the first three years of Project implementation (September 29, 1986 through September 30, 1989), accrued expenditures totaled $8,293,301. Of this amount only $2,352,498 (28 percent) reached Project beneficiaries in the form of investments and grants. In other words, for every $1 spent on investments or grants, $2.53 went to pay Project employees' salaries, contractors, or other administrative expenses. Project expenses of this magnitude do not appear justified particularly since the majority of the investments made by A.I.D. implementing agency have been losing money as shown in the financial data presented at Exhibit 3.[1]

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[1] **Exhibit 3 compares the financial performance of the Trust's investments and grants to the financial targets included in the original program description of A.I.D.'s grant to the Trust. While these targets are not included in the revised program description now found in the grant agreement, most of these targets are widely used and provide useful standards for measuring the quality and performance of the Trust's investments and grants. Most of the targets have not been met. In reviewing Exhibit 3, the reader should bear in mind that the targets for rate of return refer to the rate of return over the life of the investments and grants (up to 10 years). It is not unusual for new companies or companies undergoing reorganization to incur initial losses.**

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One such equity investment subproject of approximately $31,000 in A.I.D. funding was made in a seamoss beverage business. This business sustained a $7,600 loss on sales of $37,800 for the six months ending September 30, 1989. This equity investment was the result of a 14-month effort by Project and business officials and involved the preparation of a 30-page equity agreement and a formal 95-page "business plan."

Four other investments made by the A.I.D. implementing agent were experiencing serious economic difficulties:

-- Barte Meats (A.I.D.-funded investment of $130,589 according to RDO/C figures) lost $66,874 on sales of $78,616 during the first eight months of 1989. These losses reduced the company's net worth, a serious consequence considering the company had only $81,788 in current assets available to cover $212,798 in current liabilities (all figures taken from unaudited financial statements). The A.I.D. implementing agency is trying to arrange a merger between Barte Meats and another company to bring Barte Meats needed expertise and working capital.

-- Southern Agronomics, had received considerably more A.I.D. funding--$493,000--nonetheless, its economic prospects are similarly negative. This activity has made no sales and the managing director told us he saw no prospect of ever selling his product. This "market" information noted in the Project's "Business Plan" for this subproject was false according to the director and, according to him, Southern Agronomics does not have a market. Southern is pursuing production of a similar but more highly refined product which it hopes will be profitable.

-- Stonefort Farms (A.I.D. funding at $52,638) had no cash on hand as of November 30, 1988, according to the Farm's audited financial statements. The company had only $1 in current assets for every $14 in current liabilities. More recent information is not available since the company has no formal accounting records and still owes money to the accountants that prepared the November 1988 financial statements. However, an A.I.D. implementing agency official visited the Farm in November 1989 and found that: "The general picture was the usual one of young vegetable seedlings being planted out in land which had been inadequately cleared of weeds and in which subsequent weed growth smothered the vegetables and caused them to yield very poorly or not at all." The trustee's report also referred to the "hopelessness" of the Farm's management practices. According to RDO/C's Project manager, the A.I.D. implementing agent, belatedly, has declared the investment agreement with Stonefort Farms in default and is seeking a change in management.

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-- Windward Island Tropicals, according to unaudited financial statements, lost $76,949 on sales of $234,656 during the first eight months of 1989, and had lost $241,521 on sales of $385,446 in 1988. A $301,317 A.I.D.-funded investment was made.

Finally, Windward Island Aloe, with a Project investment of $500,000, is also experiencing a loss but appears to be in a stronger financial condition than those discussed above.

Actually, as of September 30, 1989 only one of the seven equity investments, for which we had financial information, had clearly gone to a profitable activity, a pineapple farm. While A.I.D.'s investment in this case seems secure, the impact of this $61,050 investment is negligible because this farm, established in 1968, had been an on-going profitable institution prior to A.I.D.'s involvement. Also in this regard, the farm's major stockholder stated "The investment helped, but, since the farm is an on-going profitable concern, it is hard to measure direct benefits of the equity investment." This stockholder further stated "A.I.D. and [the implementing agents] were urged to show any results under HIAMP [Project] and needed to make any investment." He added that he received the funds four months before the equity agreement was signed and, that over $10,000 in legal and accounting fees associated with this equity investment, was paid using Project funds.

Both A.I.D./Washington and RDO/C have been concerned about the Project's performance. An A.I.D./Washington team evaluated the Project in January 1988, while RDO/C redesigned the Project twice and contracted an evaluation in March 1989. RDO/C has permitted the Project to continue this far because it believes that past problems have been solved or are being solved and the Project will eventually become a success.

RDO/C expects that by July 1993 investments and grants will increase from the September 30, 1989 level of $2,352,498 to $12,670,000 while expenses associated with making these investments would increase from $5,940,803 to $10,057,000. Even if these expectations are fully realized, only 56 percent of the Project budget would have funded investments and grants. Moreover, we question whether these expectations are realistic. It is important to keep in mind that identifying and managing a portfolio of profitable investments is not an easy task under any circumstances. In the case of the High Impact Agricultural Marketing and Production Project, the task is made more difficult by the special risks associated with agricultural investments, the unfavorable business climate in the Eastern Caribbean, and the infrastructure and transportation constraints of the region.

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Finally, in order RDO/C's to meet revised targets, the implementing agency would have to increase investments during the next 3 years 285 percent over the level of investment achieved in the first 3 years of the Project (this Project has made only ten investments to date). Simultaneously, Project expenses would have to be reduced 46 percent (Exhibit 4). However, this appears contrary to the May 1989 Project evaluation recommendation against increasing the number of investments. The evaluation team, instead, emphasized management changes and the strengthening of the current investment portfolio.

We see this Project as an expensive way to loan money, since the A.I.D. implementing agency's equity agreement requires that the investment (shares) be repurchased by the "assisted" business, normally within five years. In fact, one stockholder stated that the A.I.D.'s implementing agency was "...more like a financing institution with which [he] has an outstanding loan [and] which will be repaid in the near future."

In summary, we do not find this Project, as designed and implemented, a good use of A.I.D. resources.

Management Comments and IG Response

The RDO/C believes that its approach to the development of the Trust is both prudent and consistent with A.I.D.'s policy on institutional development. They stated that "the policy paper dated March 1983 recognizes that institutional development takes time--perhaps as much as ten years."

The RDO/C commented that the Trust now appears to be on track and said that terminating this Project now would fly in the face of A.I.D. policy, undermine A.I.D.'s credibility in the Eastern Caribbean region, and undercut the Trust at a time when it deserves support.

The RDO/C believes that the audit did not accurately reflect the status of the Trust component of the Project and drew inappropriate conclusions about the Trust because of our selected audit cutoff date of September 30, 1989.

It must be emphasized, however, that we have considered Project revisions, RDO/C expectations as a result of those revisions, and overall operational results (as provided to us by RDO/C) for the 11 months post-dating our review cutoff date. And, although our opinion has not changed, we agree that Project operations after that date were not evaluated in the same detail as those before. It was for this reason that we included Recommendation No. 1b giving the RDO/C the option to continue the Project.

The RDO/C commented on their "unprecedented five reviews" of this Project and that now, as a result of these reviews and past experience, the focus of the Project needs to be changed again. In our view, however, this is still a Project in search of a purpose.

RDO/C wants to continue the Project but now change its focus to one of "creating a viable Private Sector Intermediate Financial Institution." It must be asked if the new focus will generate a beneficial and measurable regional economic impact as proposed in the original logical framework or what minimum economic benefit would be acceptable considering life-of-project costs. Having the institution should not itself be the objectively verifiable indicator of Project success. Rather, we believe, the institution should have invested wisely in companies that in fact will contribute significantly to the GDP of the region as stated in the Project's current purpose -- agricultural GDP increasing at a rate of five percent annually is the current objectively verifiable indicator. If RDO/C believes their original indicator was unrealistic, a downward revision should be considered. But, in making a revision, RDO/C should still be able to show that achieving that indicator/output level is a justifiable use of A.I.D. funds.

We are not alone in questioning the effectiveness of this Project. The May 1989 Project Evaluation Report showed existing investment portfolio failures projected at "well over 50 percent." Further, the report stated ". . .it is very doubtful that the institution responsible for HIAMP [Project] could become financially self-sustaining in the near future."

Finally, in the 13 months since our audit cutoff date (September 30, 1989), according to the latest information provided by RDO/C, only two additional equity investments in new ventures have been made. Nevertheless operational cost have continued to accumulate. Therefore, we must continue to question the viability and worth of this institution and reiterate our view that the Project should be terminated.

RDO/C requested that Recommendation 1.a. be closed as they have decided to continue the Project. With respect to Recommendation 1.b. RDO/C concurred with the recommendation and plans to have the project paper amendment completed by October 15, 1990.[2] Based on these actions we consider Recommendation 1.a. closed upon issuance of this report and Recommendation 1.b. resolved.

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[2] In subsequent correspondence with RDO/C this date was extended until November 30, 1990.

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2. Better Management of Commercialization Grants is Needed

While the grants made by Agribusiness Development have financed many innovative activities, most of the grants did not provide for disseminating the results to third parties as required by A.I.D. policy. As a result, many of the grants we reviewed have not produced any significant benefits for anyone but the grantees themselves. Also, almost none of the grants we reviewed were awarded through signed agreements between Agribusiness Development and the grantees. Thus raising legal problems in case of grantee nonperformance. These problems exist because RDO/C and Agribusiness Development needed to better focus their attention on sound administration of the commercialization grant fund.

Recommendation No. 2

We recommend that the Regional Development Office/Caribbean:

a. obtain evidence that Eastern Caribbean Agribusiness Development has adopted standard grant agreements which address, among other things, how the results of each grant will be disseminated, and

b. obtain evidence that Eastern Caribbean Agribusiness Development has signed an agreement with each grantee.

Discussion

A.I.D.'s policy on private enterprise development, dated March 1985, states that concessional assistance (including grants) to private profit-making businesses must be justified in terms of the benefits the assistance will provide to third parties.

As of September 30, 1989, Agribusiness Development has awarded 69 commercialization grants and disbursed $331,984 to the grantees. We reviewed 27 grants with disbursements of $146,620 (see Exhibit 5).

Fifteen of the 27 grant proposals and agreements we reviewed did not include provisions for disseminating the results to third parties. Of 15 grants which had produced reportable results by the time of our audit, 10 grantees stated that they had shared information with third parties while 5 stated that they had not. Where information was not shared with third parties, the grants had benefitted only the grantees themselves.

Only 2 of the 27 grants we reviewed were awarded through written agreements between Agribusiness Development and the grantees. (Six other grantees stated that they had signed agreements but Agribusiness Development did not have copies of the agreements). Moreover, the two written agreements did not cover important matters such as the costs that would be paid by Agribusiness Development and the grantee, disbursement procedures, reporting procedures, or remedies in the event of noncompliance with the terms of the agreement. Therefore, Agribusiness Development had no recourse if a grantee did not comply with the intent of a grant. For example, one grantee in St. Lucia misused $1,562 in grant funds, but Agribusiness Development had no legal recourse since it had no written agreement with the grantee.

It was evident that neither RDO/C nor Agribusiness Development have adequately focused their attention on sound administration of the commercialization grant fund. RDO/C needs to ensure that Agribusiness Development adopts standard grant agreements which address how results will be disseminated and other matters.

Management Comments and IG Response

The RDO/C agreed and stated that a standard grant agreement was developed in response to the audit's concerns. A copy was provided to us. In addition, organizations that may have an interest in grant results were contacted and provided a listing of the grants should they wish to request a report. Based upon these actions Recommendation No. 2a. is closed upon issuance of this report.

Regarding Recommendation No. 2b. the Trust has formally requested each active grantee to sign the standard agreement. The RDO/C expects this action to be completed by November 30, 1990. This recommendation, 2b., is considered resolved and will be closed when the RDO/C is in receipt of evidence that the new grant agreements have been signed.

3. More Attention to Environmental Protection Is Needed

Environmental protection measures, although required, were not always taken. In one instance a restricted herbicide, Paraquat, may have been used. In another instance pesticides were in leaking containers stored in the same facility being used for food processing; tainted waste water was being disposed in a river; and although prohibited, pesticides were being rebottled. This occurred, in part, because responsibility for enforcing A.I.D.'s environmental protection requirements were passed from RDO/C to the Trust. RDO/C needs to better assure that environmental protection measures are taken.

Recommendation No. 3

We recommend that the Regional Development Office/Caribbean:

a. obtain evidence of compliance with the environmental protection measures required by the environmental threshold decisions for Stonefort Farms and the Organization for Rural Development, and

b. review compliance with required environmental protection measures for the Agricultural Venture Trust's other investments and grants and implement any needed corrective actions.

Discussion

A.I.D.'s environmental procedures, contained in 22 Code of Federal Regulations (CFR) Part 216, require that initial environmental examinations be prepared for most projects, programs, and activities authorized or approved by A.I.D. Depending on the results of the initial environmental examination, an environmental assessment or environmental impact statement may be required.

On November 25, 1988, RDO/C sought a categorical exclusion for the High Impact Agricultural Marketing and Production Project. RDO/C's request was approved by the Latin America and Caribbean Bureau's Chief Environmental Officer on December 7, 1988.

Since the categorical exclusion was granted the Trust became responsible for ensuring that sound environmental protection measures are implemented. While we did not review environmental protection measures for 8 of the Trust's 10 grants and investments, it came to our attention that required protection measures have not been implemented for Stonefort Farm and the Organization for Rural Development. The protection measures are required by A.I.D. environmental threshold decisions. These threshold decisions, both dated

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March 3, 1989, were based on initial environmental examinations performed before the categorical exclusion was granted.

Stonefort Farm The environmental threshold decision for Stonefort Farm requires a condition precedent stating that no pesticides restricted by the U.S. Environmental Protection Agency can be used by Stonefort Farm. However, even though a copy of the decision was provided to the Trust, the Trust has not amended its January 5, 1988 equity investment agreement with Stonefort Farm to include this prohibition. Also, during a visit to the farm on April 21, 1989, the Trust's executive director and a trustee obtained an agreement from Stonefort's managing director to spray cultivated areas of the farm "with an appropriate herbicide (Roundup, Paracol, Paraquat, as required)". Paraquat is an herbicide restricted by the Environmental Protection Agency.

The Trust's executive director explained that often the only pesticides available at economical prices in the Eastern Caribbean are those restricted by the U.S. Environmental Protection Agency. He also stated that the Trust has provided Stonefort Farm with respirators and encouraged the company's personnel to handle pesticides carefully. He did not think that Stonefort Farm had actually used paraquat. We did not determine whether Stonefort Farm was in fact using paraquat or an herbicide approved for general use such as Roundup. However, it is clear that the Trust has not implemented the restriction contemplated by the environmental threshold decision for Stonefort Farm.

Organization for Rural Development The environmental threshold decision for Trust's grant to the Organization for Rural Development requires conditions precedent prohibiting the rebottling of pesticides and the use or sale of restricted pesticides. It also requires that pesticides be kept in a storage facility separate from the organization's main packing house and that the organization stop disposing of waste water tainted with fungicide in a nearby river.

None of these requirements have been met. The Trust has not amended its grant agreement with the Organization for Rural Development to include prohibitions against rebottling pesticides and the use and sale of restricted pesticides. When we visited the packing house in February 1990, we found that pesticides were not stored in a facility separate from the packing house but rather in a separate room in the basement. The storage room was locked so we could not observe what pesticides were on hand and how they were stored. However, an Agribusiness Development employee stated that when he visited the packing house in November 1989, the basement room was flooded and pesticides were leaking from corroded drums kept in the storage room. According to the marketing coordinator, the organization is still rebottling pesticides. We also observed that the Organization for Rural Development continues to dispose of tainted waste water in a river near the packing house.

J.D.

The Trust's executive director stated that the Trust had expressed its concerns regarding pesticide management in meetings with Organization for Rural Development officials. He further stated that when the Trust found out through our audit that the organization was not following sound procedures, the Trust withheld a disbursement from the organization to encourage them to handle pesticides more carefully.

In conclusion, we found that RDO/C needed to better assure that environmental protection measures were being implemented on the businesses A.I.D. was providing funding to the Trust to invest in. We found that in two cases the Trust was not enforcing required environmental protection measures.

We are recommending that RDO/C obtain evidence that Stonefort Farms and the Organization for Rural Development are implementing required environmental protection measures. Also RDO/C should review compliance with protection measures applicable to the Trust's other investments and take any required corrective actions.

Management Comments and IG Response

The RDO/C agreed and stated they will request closure of Recommendation Nos. 3a. and b. after the Trust reviews all investments for environmental compliance and implements corrective actions, if needed. Based on this, Recommendation Nos. 3a. and b. are resolved and can be closed after achievement of the planned actions have been communicated to this office.

4. Several Companies and Organizations Have Not Complied with Accounting and Audit Requirements

The agreements between the Trust and the companies and organizations it is funding require that each organization keep adequate accounting records and provide the Trust audited financial statements. Several of the companies and organizations have not complied with these requirements due to a lack of enforcement by the Trust. Consequently, the Trust can not be certain of the financial performance of the companies in which it has invested. This situation could lead to losses for the Trust.

Recommendation No. 4

We recommend that the Regional Development Office/Caribbean obtain evidence that:

a. the Agricultural Venture Trust has implemented an effective system for enforcing the accounting and audit requirements in its subagreements, and

b. the businesses and organizations receiving funds from Agricultural Venture Trust have complied with the applicable accounting and audit requirements.

Discussion

The Trust's eight equity investment agreements and the grant agreement with the Organization for Rural Development require that each organization keep records to reflect the financial condition of the Company and the results of its operations (including the progress of the Project during implementation).

The grant agreements signed with the National Development Foundation of Dominica incorporate A.I.D.'s "Mandatory Standard Provisions for Non-U.S., Non-Governmental Grantees", which state that the grantee shall maintain records, documents, in accordance with the grantee's usual accounting procedures to sufficiently substantiate charges to the grant. The provisions further state that the funds provided under the grant will be audited by an independent auditor during the course of the grantee's normal annual audit and that this audit will be subject to review and approval by the Trust.

Some of the businesses and organizations which receive funds from the Trust have not complied with these requirements. Three companies (Southern Agronomics, Stonefort Farm, and Corona Developments) have no formal accounting records.

Also, four companies (Southern Agronomics, Nonsuch, Corona Developments, and Funtime Products) have not had audited financial statements prepared. A fifth organization (the National Development Foundation) had audited financial statements prepared but the financial statements do not show how the Trust's grant was used, as required by the organization's agreement with the Trust.

These instances of non-compliance occurred because the Trust has not enforced the financial management requirements in its agreements. The Trust's executive director plans to propose to the board of trustees that, in the future, the Trust not disburse funds to any organization until the organization demonstrates that it has implemented sound accounting procedures. He also plans to get Project employees more involved in obtaining financial information from organizations using Trust funds.

Where audited financial statements and accounting records are lacking, the Trust cannot properly monitor the financial performance of the companies it has invested in. Instead, the Trust is forced to rely on intuitive impressions of how its investments are performing. This approach could easily lead to losses for the Trust.

RDO/C should obtain evidence that the Trust has implemented an effective system for enforcing accounting and audit requirements and that the businesses and organizations which have received funds from the Trust are complying with these requirements.

Management Comments and IG Response

The RDO/C agreed with the finding and stated it will request closure of the recommendation after its Controller Office reviews the Trust's system for enforcing accounting and auditing requirements and the level of compliance by existing investments. Therefore, Recommendation Nos. 4a. and b. are resolved and can be closed when the RDO/C obtains evidence that the Trust has implemented an effective system for enforcing its accounting and audit requirements and that their investments are in compliance with those requirements.

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5. Cash Advances to the Agricultural Venture Trust Exceed Immediate Disbursing Needs

A.I.D. Handbook 19 states that A.I.D. is responsible for monitoring recipient organizations to ensure that they do not maintain advances in excess of their immediate disbursing needs and that they return excess cash balances to the U.S. Treasury. In no case can advances exceed 90 days' disbursing needs. In February and April 1989, the Regional Development Office/Caribbean (RDO/C) advanced the Trust $321,019 to buy shares in two companies: Agro Industries and Sunshine Meats. At the time our audit ended in April 1990, the Trust had neither used these funds nor returned them to RDO/C. While RDO/C's subsidiary advance ledgers showed these advances were outstanding for long periods of time, responsible staff did not take action to recover the advances. By leaving this idle cash in the Trust's hands, the U.S. Government has incurred unnecessary borrowing costs of $24,766.

Recommendation No. 5

We recommend that the Regional Development Office/Caribbean review the outstanding advances to the Agricultural Venture Trust and recover advances which exceed immediate disbursing needs.

Discussion

A.I.D. Handbook 19, Appendix 1B states that A.I.D. is responsible for monitoring the cash management practices of recipient organizations to ensure that they do not maintain federal cash in excess of immediate disbursing needs and that excess cash balances are promptly returned to the U.S. Treasury. In no case can advances to an organization exceed 90 days' cash needs.

However, advances to the Trust for investments totaling $321,019 have remained idle for approximately one year. On February 13, 1989, RDO/C advanced the Trust EC$250,000 (Eastern Caribbean dollars, equivalent to $92,999) to be used to buy shares of a company called Agro Industries Ltd. On April 28, 1989, RDO/C advanced $228,020 ($215,000 plus EC$35,000 equivalent to $13,020) to be used to buy shares of Sunshine Meats, Ltd. The Trust has not spent these funds because the companies have not met conditions precedent included in the investment agreements they signed with the Trust.

The Trust's Director stated that the Trust had not returned these idle funds to RDO/C because he expected that the companies would soon meet the conditions precedent and the Trust would be able to use the funds. RDO/C's

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subsidiary advance ledgers showed that these advances were outstanding for long periods of time but responsible staff did not take action to recover the advances.

By permitting the Trust to keep $321,019 idle for such a long period of time, the U.S. Government incurred unnecessary borrowing costs of $24,766. RDO/C should review the advances outstanding to the Trust and recover any unnecessary advances.

Management Comments and IG Response

The RDO/C agreed and has reviewed outstanding cash advances. It also provided evidence that it has recovered nearly $324,000 (US) which was determined to have exceeded the Trust's immediate cash needs. Based on these actions by the RDO/C, Recommendation 5 is closed upon issuance of this report.

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B. Compliance and Internal Control

Compliance

Our compliance review was limited to the issues discussed in this report. The review disclosed three compliance exceptions.

-- Federal regulations provide for excluding A.I.D. projects from the Agency's environmental procedures. While RDO/C cited the regulations as justification for a categorical exclusion for the Project, we found that the criteria in the regulations was not met (Finding 3).

-- A.I.D. Handbook 19 limits Agency advances to 90 days' disbursing needs. Advances to the Trust for investments totaling $321,019 have been outstanding for about one year (Finding 5).

-- Although both the original Agreement with the Trust and Agreement Amendment No. 3 required A.I.D. approval prior to the signing of Trust sub-agreements, RDO/C was not approving sub-agreements until after they were signed by the Trust (Other Pertinent Matters).

Other than the exceptions cited, tested items were in compliance. We found nothing that would indicate that untested items were not in compliance with applicable laws and regulations, binding A.I.D. policies and procedures, and agreement terms.

Internal Control

Our review of internal control was limited to the audit objectives and issues discussed in this report. The review disclosed several internal control weaknesses within A.I.D.'s implementing agencies. These review results are being transmitted to RDO/C in a separate management letter.

Nothing else came to our attention to indicate that areas not reviewed lacked adequate internal control.

C. Other Pertinent Matters

The following sections discuss two minor problem areas that require management attention.

Apparent Conflict of Interest

The grant agreement between the Regional Development Office/Caribbean (RDO/C) and the Trust states that the Trust shall exercise vigilance to avoid any actual or apparent conflicts of interest on the part of its trustees. One of the trustees also works for the Trust as an agricultural advisor reporting to the executive director. This individual earns $500 per month as a trustee and $1,930 per month as an agricultural advisor. While his contract as an agricultural advisor does not specify how many days he must work, according to the Trust's executive director he is expected to work at least 12 days per month. At the time RDO/C approved this arrangement, the Mission did not believe that this arrangement involved a conflict of interest. While we did not find any evidence that the individual's judgment as a trustee was influenced by the fact that he was also an employee of the Trust, we believe that this arrangement does present at least an apparent conflict of interest. We believe it is unreasonable to expect an employee of the Trust to maintain the independent judgment required of a trustee. In other words, this individual as a trustee is responsible for approving new investments, while as an agricultural advisor he is responsible to provide guidance on the preparation of business plans proposed to Trust for investment approval. While we are not making a formal recommendation, RDO/C should limit this individual's role to either a trustee or an employee but not both.

Approval of the Trust's Sub-agreements

The original grant agreement with the Trust, as well as agreement amendment No. 3, required prior RDO/C approval of all Trust subagreements for investments and grants. In practice, a different procedure was followed. RDO/C approved business plans before subagreements were signed by the Trust, but never approved subagreements until after they were signed by the Trust. This could potentially create problems if any of the signed subagreements contained provisions which were not acceptable to RDO/C. We are not making a formal recommendation because RDO/C plans to sign an amendment to the grant agreement which would delete the requirement for prior approval of Trust subagreements. If for any reason RDO/C does not sign the new amendment, it should begin approving subagreements before they are signed by the Trust.

AUDIT OF
THE HIGH IMPACT AGRICULTURAL
MARKETING AND PRODUCTION PROJECT
REGIONAL DEVELOPMENT OFFICE/CARIBBEAN
PROJECT NO. 538-0140

PART III - EXHIBITS AND APPENDICES

EXHIBIT 1

Project Financial Status
As of September 30, 1989
(Unaudited)

Category	Obligations	Disbursements	Accrued Expenditures	Advances
AVT and ECAD Administrative expenses	6,816,392	5,046,979	5,395,699	243,281
AVT	1,707,200	511,718	568,918	243,281
ECAD	5,109,192	4,535,261	4,826,781	0
Equity Investment and Grants	6,490,914	1,946,990	2,020,514	598,584
Commercialization Grants	500,000	331,984	331,984	0
RDO/C Administrative Expenses	1,020,561	497,526	545,104	51,515
Participating Agency Service Agreements and Personal Services Contractors	467,486	158,937	174,570	0
A.I.D. Direct Disbursement (fruit fly surveys and technicians	353,300	176,260	199,351	51,515
Evaluations and Assessments	156,545	129,495	137,495	0
Technical Services	16,482	16,133	16,482	0
Invitational Travel	14,331	14,331	14,331	0
Printing and Advertisements	12,417	2,370	2,875	0
Totals	$14,827,867	$7,823,479	$8,293,301	$893,380

Source: Regional Development Office/Caribbean reports. Information for the commercialization grant line item is as reported by Eastern Caribbean Agribusiness Development.

Comparison of Planned and Actual Accomplishments as of September 30, 1989

Purpose and Outputs 1/	Objectively Verifiable Indicators 1/	Accomplishments as of September 30, 1989 2/	Percent of Targets Achieved
PROJECT PURPOSE: To increase the contribution of the agricultural sector and associated agricultural enterprises to Gross Domestic Product by improving the investment environment, relieving development contraints to private capital inflows, and demonstrating attractive returns on capital at at acceptable levels of risk.	Agricultural GDP increasing at a rate of 5 percent per annum.	No apparent contribution to agricultural GDP with most firms receiving funds under the project for which financial statements were available were losing money.	0 percent
OUTPUTS: Expansion or establishment of profitable agricultural production and/or processing enterprises producing for the local and export markets.	Equity fund investments made to 28 firms and reimburseable grants made to 14 firms.	Equity investments in 8 firms made.	29 percent
		Reimbursable grants to 2 organizations made.	14 percent
Establishment of efficienty - managed, profitable equity finance fund for non-traditional export agriculture within the Agricultural Venture Trust.	Value of AVT equity fund does not decline during project life; staff members trained and actively seeking new agricultural investments.	Not determined.	
Increased lending to HIAMP agricultural enterprises by intermediary financial institutions.	Intermediary financial institutions to disburse $3 million in loan funds throughout project life.	The five firms for which balance sheets were available had long-term debt from all sources of $359,656. 3/	12 percent

Notes: 1/ RDO/C is revising the targets for the High Impact Agricultural Marketing and Production Project.
2/ As of September 30, 1989, 44 percent of the planned project life had passed.
3/ Information on long-term debt is taken from the latest financial statements available. The dates of these financial statements ranged from November 1988 through September 1989..

EXHIBIT 2

EXHIBIT 3

Financial Performance of Agricultural Venture Trust Investments and Grants

Business or Organization (Date of First AVT Disbursement)	Information for Period	Internal Rate of Return	Return on Equity	Economic Internal Rate of Return	Debt/ Equity	Current Assets/ Current Liabilities	Acid Test 1/	Net Operating Profit/Interest Payment	Sales/ Assets 2/	Return on Sales
		(Target 15%)	(Target 15%)	(Target 10%)	(Target Max.2.5)	(Target .8-2.0)	(Target .6-1.2)	(Target 2.0)	(Target .8-1.5)	(Target .04-.1)
Windward Island Tropicals (1/88)	1/89 - 8/89 3/	Negative return	Negative return	Negative return	0.12	1.27	0.21	Negative return	0.22	Negative return
Barte Meats (10/88)	1/89 - 8/89 3/	Negative return	Negative return	Negative return	3.63	0.38	0.14 4/	Negative return	0.31	Negative return
Stonefort Farm (1/88)	3/88 - 11/88	Negative return	Negative return	Negative return	0.24	0.07	0	Negative return	0.03	Negative return
Windward Islands Aloe (1/88)	3/89 - 9/89 3/	Negative return	Negative return	Negative return	0.20	0.78	0.49	Negative return	0.18	Negative return
Corona Developments (8/89)	No financial statements prepared since AVT purchased shares									
Southern Agronomics (9/88)	No financial statements prepared since AVT purchased shares 5/									
Nonsuch (1/88)	1/88 - 12/88 3/	Not Available (N.A.)	N.A.	N.A.	N.A.	N.A.	N.A.	2.92	N.A.	0.02
Funtime Products (8/89)	3/89 - 9/89 3/	Negative return	Negative return	Negative return	0.17	No current liabilities	No current liabilities	Negative return	0.9	Negative return
Organization for Rural Development (12/88)	No financial statements since AVT made grant									
National Development Foundation of Dominica (10/87)	Financial statements did not shows status of AVT grant									

1/ (Current assets - inventories-prepaid expenses)/current liabilities
2/ Where available sales figures covered less than one year, we estimated annual sales. For example, Windward Island Tropicals reported sales of $234,656 during the first eight months of 1989. We estimated annual sales as follows: (12x$234,656)/8=$351,984.
3/ Information reported by companies was unaudited.
4/ Prepaid expenses are included in calculation.
5/ Management stated no sales have been made to planned markets.

Projected Expenditures Based on Budget in Project Paper Amendment No. 3

	(1) Expenditures for first 36 months of project	(2) Project paper amendment No. 3 projected Expenditures for life of project	(3) Projected expenditures for second 46 months of project (Col. 2 - Col. 1)	(4) Projected expenditures prorated for second 36 months of project (Col.3X.78)	(5) Projected change in expenditures from first 36 months to second 36 months of project ([(Col.4-Col.1)/Col.1]X100)
Agricultural Venture Trust investments and grants	$2,020,514	$12,000,000	$ 9,979,486	$7,783,999	+285%
Commercialization grants	331,984	670,000	338,016	263,652	- 21%
Subtotal (investments and grants)	$2,352,498	$12,670,000	$10,317,502	$8,047,651	+242%
Operating costs	5,940,803	10,057,000	4,116,197	3,210,634	46%
Total	$8,293,301	$22,727,000	$14,433,699	$11,258,285	+ 36%

Source: Unaudited information provided by RDO/C and ECAD.

EXHIBIT 4

List of Commercialization Grants Reviewed

Country/Grantee	Date	Amount Disbursed as of 30-Sep-89 (in US $)	Purpose	Were there provisions for disseminating results?	Was an agreement signed?
ANTIGUA					
1. Nonsuch, Ltd.	29-Apr-87	$7,071	Papaya trials	Yes	No
2. Rooms Estate Farm	22-Dec-88	3,992	Cotton production	No	No
BARBADOS					
3. Best of Bajan Delicacies	21-Jul-89	1,191	Smoked product marketing	No	No
4. Caribbean Agricultural Research Development Institute	16-Jun-87	6,132	Cut-flower research	Yes	No
5. Caribbean Agricultural Trading Co.	03-Feb-89	929	Cut-flower marketing	No	No
6. Caribbean Agricultural Trading Co.	23-Nov-88	9,366	Pumpkin marketing	No	No
7. Friendship Plantation	19-May-89	5,378	Hay dryer testing	No	No
DOMINICA					
8. Ministry of Agriculture	30-Aug-88	5,794	Carambola nurseries	Yes	No
9. Ministry of Agriculture	20-May-88	4,201	Passion fruit nurseries	Yes	No
10. Ministry of Agriculture	10-Jan-89	7,068	Red pepper nurseries	Yes	No
11. LaRonde & Mitchel	27-Feb-89	5,060	Greenhouse construction	Yes	No
12. Morpo & Grand Coulibri Estate	22-Dec-88	1,021	Spineless christophene trials	No	Yes 1/
13. Watty & Alleyne	29-Jan-87	10,000	Ginger lily production & marketing	Yes	No
GRENADA					
14. Inter-American Institute for Cooperation on Agriculture	04-May-89	338	Papaya trials	Yes	Yes 1/
15. Wharf Agricultural Co. of Grenada	18-Jan-88	7,953	Garlic & okra production	No	Yes

List of Commercialization Grants Reviewed

Country/Grantee	Date	Amount Disbursed as of 30-Sep-89 (in US $)	Purpose	Were there provisions for disseminating results?	Was an agreement signed?
ST. KITTS					
16. Stonefort Farm	16-Jul-87	$5,489	Papaya trials	No	No
ST. LUCIA					
17. Caribbean Agricultural Trading Co.	30-Mar-87	8,936	Mango upgrading	No	No
18. H. F. Jn. Baptiste, Ltd.	29-Dec-88	5,264	Harvesting technique improvement	No	No
19. National Enterprises	17-Aug-88	5,912	Harvesting technique improvement	No	No
20. Ramier Estates	27-Nov-87	6,994	Vegetable trials	Yes	Yes
ST. VINCENT					
21. Erica's Country Style Products	18-Jul-88	10,000	Food processing & marketing	No	No
22. First Base Design	22-Dec-88	6,010	Coconut oil body products	No	No
23. Organization for Rural Development	16-Jul-87	9,319	Ginger production	Yes	Yes 1/
24. Organization for Rural Development	05-Aug-87	6,150	Turmeric production	Yes	Yes 1/
25. Ricardo Drayton	28-Mar-88	4,848	Vegetable production and/marketing	Yes	Yes 1/
26. Ricardo Drayton	03-Dec-87	2,175	Rabbit meat production	No	Yes 1/
27. Ruben Robinson	03-Dec-87	29	Papaya production	No	No
Total Amount Disbursed		$146,620			

1/ The grantee advised us that an agreement had been signed; however, the agreement could not be located.

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Scope and Methodology

A. Scope

We audited the Regional Development Office/Caribbean's High Impact Agricultural Marketing and Production Project in accordance with generally accepted government auditing standards. We performed the audit field work from November 21, 1989 through April 19, 1990 in Antigua, Barbados, Dominica, Grenada, St. Kitts, St. Lucia, and St. Vincent. The audit covered the period from July 20, 1986 through September 30, 1989. However, auditee officials provided certain additional information concerning the Project's accomplishments after that date and this information is also discussed in the report.

The audit covered A.I.D. disbursements of $7,823,479 (excluding accrued expenditures) and advances of $893,380 as of September 30, 1989. Our examination was limited to the review of documentation required to accomplish the audit objectives. Our objectives did not include expressing an opinion on the accuracy or allowability of expenditures and advances. No counterpart contributions to the Project were required.

B. Methodology

The methodology for each audit objective follows.

Audit Objective One: Determine the extent to which planned results and benefits were being achieved.

In order to accomplish the first objective, we reviewed documentation including the project paper, Trust's grant agreement, and Agribusiness Development's contract to determine what the Project was intended to accomplish. To determine the actual results of the Project to date, we reviewed reports prepared by the Trust, Agribusiness Development, and RDO/C; reviewed two Project evaluations; interviewed Trust, Agribusiness Development, and RDO/C officials, and visited the sites of 10 Trust investments and grants and 25 of the 27 Agribusiness Development commercialization grant included in our review.

We visited all 10 investments and grants that the Trust had made disbursements to as of September 30, 1989. In reviewing Agribusiness Development commercialization grants, we initially reviewed all four commercialization grants on the island of St. Lucia for which Agribusiness Development had made disbursements as of September 30, 1989. In reviewing Agribusiness Development commercialization grants, we initially reviewed all four commercialization grants on the island of St. Lucia for which Agribusiness Development had made disbursements as of September 30, 1989. We subsequently randomly selected an additional 19 grants for which Agribusiness Development had made disbursements. If a selected grantee was implementing more than one grant, we included the other grants in our sample as well. In total we sampled 27 of the 69 grants Agribusiness Development had awarded as of September 30, 1989.

Audit Objective Two: Determine whether the environmental protection procedures recommended for the Project's investments and grants were being implemented.

To accomplish the second objective, we reviewed A.I.D.'s environmental procedures, RDO/C's request for a categorical exclusion from the environmental procedures, and RDO/C's approvals of Trust sub-agreements. We also interviewed RDO/C officials to obtain their views on whether or not the categorical exclusion was justified.

Audit Objective Three: Determine compliance with audit and accounting requirements.

In accomplishing this third objective, we reviewed all ten equity investment and grant subagreements, and determined the existence of audited financial statements and accounting records associated with those investments.

Audit Objective Four: Determine if cash was being advanced to the implementing agency in excess of their immediate needs.

To accomplish the fourth objective we reviewed disbursement documentation at the RDO/C. Specifically we checked the dates of these disbursement actions against disbursement activity by the Trust.

AUDIT OF THE HIGH IMPACT AGRICULTURAL MARKETING AND PRODUCTION PROJECT REGIONAL DEVELOPMENT OFFICE/CARIBBEAN PROJECT NO. 538-0140

RDO/C RESPONSE

September 7, 1990

AUDIT OF THE HIGH IMPACT AGRICULTURAL MARKETING AND PRODUCTION PROJECT REGIONAL DEVELOPMENT OFFICE/CARIBBEAN PROJECT NO. 538-0140

RDO/C RESPONSE

PART I - OVERVIEW OF AUDIT

The RIG audit brought to RDO/C's attention several matters of importance concerning project implementation, many of which have already been addressed. Regarding the RIG recommendation that RDO/C consider terminating the project, RDO/C believes that the audit report did not support its critical recommendation in this regard.

As background, over the past two-and-one-half years, RDO/C has looked seriously at the structure of the Agricultural Venture Trust (AVT), undertaking an unprecedented five reviews (management and financial). As a result of these evaluations and insight gained from implementation experience, the objective of the AVT component of the HIAMP project has been changed from one that focused on infusing resources directly into the agricultural sector of the Eastern Caribbean to one that focuses on creating a viable Private Sector Intermediate Financial Institution (IFI) targeting the development of agricultural exports and the creation of a self-sustainable Agricultural Venture Trust (AVT). This implies a longer term commitment by AID to the project. This change was not properly analyzed by the auditors because of RIG's selected cutoff date of September 30, 1989.

The RIG Audit Report did not adequately consider several other important factors which are germane to understanding the AVT component of the HIAMP project:

- The audit report failed to consider two independent financial performance evaluations, one performed in May 1988 and the other performed as part of the 1989 evaluation. Both of these analyses indicate that the AVT can be a viable institution.

- The audit report also did not consider the uniqueness of the AVT equity financing mechanism within the AID context and its focus on agribusiness, a risky sector anywhere in the world.

- The auditors did not fully appreciate that the AVT is a private sector entity, operating in a "bottom line", private sector environment. Thus, it was, in our judgement, overly negative concerning several of AVT's investments.

Furthermore, RDO/C believes that its approach to the development of the AVT is both prudent and consistent with AID's policy on institutional development. The policy paper dated March, 1983 recognizes that institutional development takes time--perhaps as much as ten years--when it states:

> *"Institutional development takes time--time to build capacity, time to develop effective working relationships with local populations, time to adapt...to on-the-ground circumstances."*[1]

The AVT illustrates this point perfectly. It experienced growing pains as it started up. Changes have been and are being made to deal with these typical development problems and, after only two years of operation, the AVT now appears to be on track. Terminating this project at this time under the circumstances described above would fly in the face of AID's policy, undermine AID's credibility in the Eastern Caribbean region, and undercut the AVT at a time when it deserves our support.

For reasons outlined above, the RDO/C believes that the audit did not accurately reflect the status of the AVT component of the HIAMP project and thus drew inappropriate conclusions about the AVT.

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[1] AID's Policy Paper: Institutional Development, March 1983, page 7.

PART II - RECOMMENDATIONS AND RESPONSE

I. PROJECT ACCOMPLISHMENTS

A. RIG/A Recommendation #1

RIG/A Recommendation #1 has two parts, i.e., that RDO/C:

1a.[2] Decide whether to terminate the HIAMP Project or allow it to continue and,

1b. If the Mission decides to allow the project to continue, prepare a project paper amendment with life-of-project targets and indicators which will justify project continuation and which can be realistically achieved before the project assistance completion date.

B. RDO/C Decisions and Actions

Given the following discussion, recent changes, independent assessments of project timeliness and direction, and confidence in the AVT's reorganization, RDO/C has decided to:

1a. *Continue its support of the HIAMP/AVT project.* ***With this decision, RDO/C requests closure of recommendation #1a in the final audit report.***

1b. *Define targets and indicators for the AVT, in view of its IFI role, in a Project Paper Amendment to be completed by Nov. 30, 1990.* ***A draft of this PP Amendment currently is under review and RDO/C will request closure of recommendation #1b upon its formal submission and Mission approval.***

C. RDO/C Response to Recommendation #1a and #1b

1. Cost Considerations

In making the first recommendation, RIG/A believes that past operating costs and the perceived condition of the AVT's portfolio suggest a project in trouble. RDO/C can do little about sunk project costs. However, for the last two years, RDO/C has implemented actions to reduce the AVT's cost of achieving its investment targets.[3]

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[2]Recommendation numbers refer to those in the revised draft audit.

[3]As noted in the Executive Summary, both RIG/A and RDO/C can provide upon request RDO/C's complete response regarding cost considerations.

There is still room for improvement, indeed there must be improvement if the AVT is to be viable. The AVT is approaching the issue from two angles. First, the Trust has projected a decrease in annual recurrent costs to less than 10% of its portfolio when fully invested.

Second, once the AVT solidifies both its operations and portfolio (over the next six months), RDO/C fully expects other donors to increase the AVT's investment capital before the PACD, thereby further reducing the operating cost to investment ratio. In fact, the AVT is devising its strategy for attracting new capital and has had positive preliminary discussions with the Commonwealth Development Corporation and the InterAmerican Development Bank regarding possible participation. To the extent that the AVT is successful at increasing its invested portfolio value and maintaining recurrent expenditures at projected levels, real operating costs will fall far below 10% of invested value.

2. Investments

The AVT is closely monitoring the rate of disbursement and anticipates significant improvement in the rate of disbursement over the next six months.[4] Given an approved portfolio value of $6.3 million, to commit all $12 million in equity funds by the end of calendar year 1992, the AVT must agree to invest $2.85 million a year. At an average AVT investment value of $225,000, the AVT must approve 13 new investments a year. The present AVT pipeline of investments in some stage of development totals more than 30 opportunities; this is before follow-on investments.

The AVT fully expects to disburse $3 million by June 1991, of which the AVT has requested $1 million. Moreover, following its three year strategic plan, the AVT confidently expects to maintain this rate of disbursement over the remainder of the project's current AID life to June 1993. Therefore, the AVT anticipates fully placing the $12 million in agribusiness investments by PACD.

3. AVT Investment Portfolio Review

To determine a return on an investment sold today, an investor would consider his/her cash flow from that investment. To determine a return on an investment for sale many years from now, an investor must consider his/her cash flow to date and must estimate future cash flows based on company knowledge and operating plans. Consequently, since the AVT does not intend to liquidate its position in any company for some time, the rate of return calculations presented in the audit report's Exhibit Three are incomplete. These calculations consider only historical cash flow without the necessary future cash flow projections.

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[4]As noted in the Executive Summary, both RIG/A and RDO/C can provide upon request RDO/C's complete response regarding investments.

Equity portfolios are risky. Investing in agribusiness in the Eastern Caribbean is even more risky. With the present investment milieu, it is noteworthy that not one AVT investment has failed. This is not to predict that there will not be failures, as no failures would mean that the AVT is not taking enough risks. Still, the survival rate to date is commendable.[5]

At any one time, the portfolio may look stronger or weaker than at another time. Formulating an opinion about the strength or weakness of an equity portfolio requires an in-depth review of trends and investments comprising the portfolio. This was not possible during the RIG audit. Given its knowledge of the AVT's portfolio, RDO/C believes that the AVT has a well diversified portfolio that holds promise for significant future returns.

[5]As noted in the Executive Summary, both RIG/A and RDO/C can provide upon request RDO/C's complete response regarding the AVT's portfolio.

[--Deleted-- Related to issue not included in final report]

III. COMMERCIALIZATION FUND GRANTS

A. *RIG/A Recommendation #2*

RIG/A Recommendation #2 has three parts, i.e., that RDO/C:

2a. Obtain evidence that ECAD has adopted standard grant agreements which address, among other things, how the results of each grant will be disseminated.

2b. Obtain evidence that ECAD has signed an agreement with each grantee.

[--Deleted-- Related to issue not included in final report]

B. *RDO/C Response*

Recommendation #2a. and Recommendation #2b.

The AVT's contractor has developed a standard grant agreement that allows the AVT to gather and use information as it deems appropriate (See Attachment C). In addition, organizations that may have an interest in grant results have been contacted and given a list of grants should they wish to request a report (See Attachment D). Finally, where a current recipient has an outstanding balance, the AVT is requesting that the recipient now sign the standard grant agreement (See Attachment E). Given these developments,

2a. *RDO/C requests closure of recommendation #2a in the final audit.*

2b. *By November 30, 1990, RDO/C will request closure of recommendation #2b, upon confirmation that the AVT's representatives have sought to sign agreements with Commercialization Fund grant recipients with an active outstanding balance.*

[--Deleted-- Related to issue not included in final report]

V. *ENVIRONMENTAL PROTECTION*

A. ***RIG/A Recommendation #4*** [Recommendation #3 in the final report]

RIG/A made three recommendations on environmental protection, two regarding oversight of environmental protection procedures and one concerning their perception of RDO/C's role in the investment process. RIG/A recommended that RDO/C:

[--Deleted-- Related to issue not included in final report]

4b. Obtain evidence of compliance with the environmental protection measures required by the environmental threshold decisions for Stonefort Farms and ORD.

4c. Review compliance with required environmental protection measures for the AVT's other investments and grants and implement any needed corrective actions.

B. *RDO/C Response*

As an IFI, the AVT has established acceptable policies and procedures (including environmental) to determine for itself the soundness of an investment decision. In light of the AVT's IFI role and its environmental policies and procedure, AID/W granted a categorical exclusion. RDO/C reviews the AVT's investment decisions to determine compliance with relevant AID policy determinations, e.g., citrus or textile, and to enable the RDO/C to earmark the necessary investment funds, as the AVT operates on an advance and liquidation basis rather than through reimbursements.

[--Deleted-- Related to issue not included in final report]

4b/c. *RDO/C will request closure of recommendations #4b and #4c after the AVT reviews all investments for environmental compliance and implements corrective actions, if needed. RDO/C expects closure by December 31, 1990.*

VI. COMPLIANCE WITH AVT ACCOUNTING AND AUDIT REQUIREMENTS

A. ***RIG/A Recommendation #5*** [Recommendation #4 in the final report]

RIG/A noted that the AVT has signed equity agreements, between itself and the companies comprising its portfolio, that call for maintenance of accounting records and provision of financial information to the AVT. RIG/A recommended that RDO/C obtain evidence that:

5a. The AVT has implemented an effective system for enforcing its accounting and audit requirements in its sub-agreements.

5b. The businesses and organizations receiving funds from the AVT have complied with the applicable accounting and audit requirements.

B. *RDO/C Response*

The AVT understands the importance of financial information and the AVT believes that it offers more than money to companies by providing management assistance and teaching financial discipline. The AVT has encouraged and demanded that proper accounting personnel be hired (or arrangements for services made) and that operating budgets provide for a yearly audit. The AVT has sent its own people, at its expense, to provide technical assistance.

In addition, the AVT is establishing a reporting format for each of its investments to facilitate home office review and is writing a new standard condition precedent to disbursement that requires an acceptable accounting system be in place with the first installment of the investment.

5a/b. *RDO/C will request closure of recommendations #5a and #5b upon review by RDO/C Controller's Office of the AVT's system for enforcing accounting and audit requirements and the level of compliance by existing investments. RDO/C expects to seek closure by November 30, 1990.*

[--Deleted-- Related to issue not included in final report]

[--Deleted-- Related to issue not included in final report]

VIII. INVESTMENT ADVANCES TO THE AVT

A. *RIG/A Recommendation #7* [Recommendation #5 in the final report]

RIG/A has recommended that RDO/C review the outstanding advances to the AVT and recover advances which exceed immediate d sbursing needs.

B. *RDO/C Response*

RDO/C reviewed outstanding investment advances to the AVT and has recovered all advances exceeding immediate investment needs. Attachment H contains supporting documentation.

7. *RDO/C requests closure of recommendation #7 in the final audit report.*

List of Report Recommendations

Page

Recommendation No. 1 5

We recommend that the Regional Development Office/Caribbean:

a. decide whether to terminate the High Impact Agricultural Marketing and Production Project or allow it to continue, and

b. if the Mission decides to allow the Project to continue, prepare a project paper amendment with life-of-project targets and indicators which will justify Project continuation and which can be realistically achieved before the project assistance completion date.

Recommendation No. 2 11

We recommend that the Regional Development Office/Caribbean:

a. obtain evidence that Eastern Caribbean Agribusiness Development has adopted standard grant agreements which address, among other things, how the results of each grant will be disseminated, and

b. obtain evidence that Eastern Caribbean Agribusiness Development has signed an agreement with each grantee.

Recommendation No. 3 13

We recommend that Regional Development Office/Caribbean:

a. obtain evidence of compliance with the environmental protection measures required by the environmental

APPENDIX 4

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