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**SIXTH AND SEVENTH REPORTS OF THE
AUDIT REVIEW COMMITTEE (ARC)**

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The Executive Committee, at its Twentieth and Twenty-first Regular Meetings, received with satisfaction the Sixth and Seventh Reports of the Audit Review Committee (ARC), respectively, congratulated the members of that Committee for their work, and resolved to forward the reports to the Inter-American Board of Agriculture (IABA), at its Eleventh Regular meeting, for its information.

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**REPORT OF THE AUDIT REVIEW COMMITTEE
(Sixth Annual Report)**

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The Audit Review Committee (ARC) was established in September 1993 by Resolution 231 of the Inter-American Board of Agriculture. Present members are Jocelyn Thompson from Trinidad and Tobago, Luis B. Correa Sanchez from Mexico, and James R. Ebbitt from the United States. The Committee met at IICA Headquarters from May 1-3, 2000 and also visited the Cooperation Agency in El Salvador from May 4-6, 2000.

AUDIT REVIEW COMMITTEE ACTIVITIES

During our visit to El Salvador in May 2000, we had the opportunity to have a meeting with the Director General, other Directors from IICA Headquarters and Representatives of the Cooperation Agencies in the Central Region, who were meeting in El Salvador regarding business of the Central Region. This was a very good opportunity for members of the Audit Review Committee to explain the workings of the ARC and to exchange views with these Representatives regarding internal controls over IICA operations. We also visited IICA's Cooperation Agency in El Salvador where we met with the Representative and staff from the Cooperation Agency and discussed issues related to the work of the ARC and the work of IICA in El Salvador.

We also had the opportunity to make a field visit in El Salvador and to see first hand, IICA projects in action and meet the people associated with those projects. We visited the Prochalate, Hillsides Project in Chalatenango, El Salvador, and had the opportunity to meet project leaders as well as people involved in carrying it out. What was very clear to members of the ARC was the enthusiasm and dedication to the project of the people we had the opportunity to meet. All associated with the project expressed the importance of the project to the community and the real and positive impact the project had on their lives. Those we met spoke strongly, enthusiastically and emotionally about the project and its positive impact. We would like to express our appreciation to the officials of the Cooperation Agency and the people associated with the Prochalate project for their warm reception and for the courtesies they extended to us.

EXECUTIVE SUMMARY OF AUDIT REVIEW COMMITTEE OBSERVATIONS

According to the Statute of the Audit Review Committee, the Committee's only reporting mandate is to call to the attention of the Executive Committee and the Inter-American Board of Agriculture, anything that in its judgment may constitute a violation of the rules of procedure governing the operation of the General Directorate. Based on our work, we have found no instances nor do we have any indication of violations of the rules of procedure.

We have also reviewed the External Auditors Report for the comparative financial statements for 1999 and 1998 and their Report on the Review of the Internal Control Structure for 1999. We met with the Audit Partner and audit staff of KPMG Peat Marwick (the External Auditor) and are pleased to report that we find the work performed by the External Auditor to be thorough and in accordance with the rules of procedure of IICA and Generally Accepted Auditing Standards. In the Report on the Internal Control Structure, the External Auditors point out a number of internal controls issues that IICA management must address. Some of our observations herein are based on the Report on Internal Controls.

OBSERVATIONS

1. **Closing Obligations and Various Accruals** – We noted in previous reports that IICA does not follow Generally Accepted Accounting Standards in its handling of closing obligations. IICA rules establish that obligations to acquire goods and services that are PENDING at the close of each fiscal year shall be included as part of total expenses for that year and should be recorded as accounts payable at the close of the same year. Generally Accepted Accounting Principles require the accounting or recognition of goods or services when an entity has a current obligation as a result of a past event and it is probable that funds will be disbursed to settle the obligation and a reasonable estimate can be made of that estimate. IICA's rules for handling closing obligations cause the external auditors to qualify their opinion regarding the preparation of IICA's financial statements. The External Auditors report states that "the financial statements of IICA have been prepared in conformity with generally accepted accounting principles, except for obligations assumed during the year to acquire goods and services not yet received at the close of the respective year."

In 1997 the external auditors noted that IICA obligated US\$2.9 million for goods and services within the last few days of the financial reporting year, and that 19 percent of this amount affected the quota budget. In 1998, the external auditors reported a similar situation and they noted that US\$2.6 million was obligated in the last few days of the financial reporting year, and that 42 percent affected the quota budget. In 1999, the external auditors reported that US\$2.8 million was obligated in the last few days of the reporting year and that 57 percent affected the quota budget. The external auditors noted in their report on internal control in 1997 that there is a danger of misuse of funds by following current IICA procedures. In their report for 1998, the external auditors stated that: "Although financial regulations establish that budgetary reserves should remain available until two years after the close of the fiscal year in which the respective commitment was made, the possibility should be analyzed of defining prudent terms (based on the justification for recording the closing obligation) that govern the execution of commitments and facilitate control over management of this area. The establishment of prudent terms could help ensure that reserves correspond to commitments with a high certainty of realization."

In an effort to control year-end obligations, the Director General issued a letter in September 1999 providing guidance and caution on year-end expenditures. This letter and follow-up letters issued in October and December 1999 also provided that any closing year obligation should be executed in the following fiscal year. The ARC believes that these letters issued by the Director General, the Deputy Director General, the Director of Human Resources and the Director of Coordination and Planning, coupled with the continued emphasis by the Director of Finance, has moved IICA closer to a position which will lead to eventually being able to remove the qualification regarding Generally Accepted Accounting Principles by the external auditors. The removal of this qualification and the adoption by IICA of Generally Accepted Accounting Principles for these procedures will increase assurance in the financial procedures of IICA.

2. **Restatement of the Financial Statements** – The ARC would like to call the Executive Committee's attention to Note 10 of the audited Financial Statements. As a result of the Institute's work in Brazil in 1999, the Institute determined that an item amounting to US\$489,653 was included by error as miscellaneous income in the Regular Fund. The amount was correctly assignable to the Trust Fund being administered by the Cooperation Agency in Brazil. The correction to the financial statements results in a reduction of a like amount in the Regular Fund. The External Auditors verified the accuracy of this accounting adjustment. The resulting change impacts and changes the financial statements for 1996, 1997, and 1998, which are explained on pages 20 and 21 of the report on the Financial Statements for 1999.

3. **Internal Audit** – The ARC would like to recognize the continued high quality work of the Internal Audit Unit within IICA. The Internal Auditor and staff continue to do high quality work on behalf of IICA. Additionally, the overall coordination provided by the Committee on Internal Audit Coordination continues to function in an efficient and effective manner. This Committee brings focus and assures appropriate corrective action on findings and issues identified during their reviews. We would also like to recognize the coordination between the Internal Auditor and the Consortium for Planning and Coordination, Directorate of Programming and Evaluation (DIPRE). This Consortium developed and has implemented a systematic process to monitor the Institute's technical cooperation, which allows the Institute to have an evaluative process to measure progress made in reaching the goals set out in the Medium Term Plan, as well as the impact of technical cooperation actions. In conjunction with the work of the Internal Auditor, this process allows IICA to have a comprehensive evaluation of its activities.

4. **BAAN** – IICA approved a new Management Information System, BAAN, in April 1999, and during our visit, the ARC was advised that the installation in Brazil had occurred and that testing was under way. If testing is successful, IICA was going to make a decision for further implementation to include Headquarters in San Jose and the Cooperation Agency in Panama.

5. **INFORMATION TECHNOLOGY CONTROLS** – The ARC would like to bring to the attention of the Executive Committee, the External Auditor's report on IICA's Internal Control Structure as it relates to General Information Technology Controls. These controls, developed or implemented by IICA, are vitally important to the Institute's

information technology systems. The External Auditor, in its report, has noted "significant weaknesses" in security over these systems. The issues are detailed in the Auditor's Internal Control Structure Report, dated May 2, 2000, Part B, page 1-8. The audit report details a number of recommendations and management has established a corrective action plan to address the recommendations. The ARC believes that this area poses a significant risk for IICA and that strong and persistent corrective action is required.

6. **CONTINUITY OF OPERATIONS PLAN (COOP)** – The ARC would also like to bring to the attention of the Executive Committee the observation of the External Auditor regarding the ability to continue operations in the event of massive damage to computer servers. Presently, IICA has no alternative information processing options in the event of damage to the servers. The External Auditor recommends that IICA make a significant effort to initiate preparation of a Disaster Recovery Plan (COOP Plan), enabling it to establish mechanisms to confront undesirable events and minimize the potential effect on the continuity of Institute operations.

7. **DIRECTORATE OF FINANCE** – The ARC would also like to recognize the strong support and cooperation of the entire Directorate of Finance. The cooperation and assistance received from this Directorate in particular is vitally important to the role of the ARC and allows the ARC to function efficiently and effectively. We would like to thank everyone who works in this Directorate for their hard work and continued support.

Jocelyn Thompson

James R. Ebbitt

Luis B. Correa Sanchez

SEVENTH REPORT OF THE AUDIT REVIEW COMMITTEE (ACR)

The Audit Review Committee (ARC) was established in September 1993 by Resolution 231 of the Inter-American Board of Agriculture. During the calendar year 2000 and continuing until July 1, 2001, members on the committee were Jocelyn Thompson from Trinidad and Tobago, Luis B. Correa Sanchez from Mexico, and James R. Ebbitt from the United States. (Mr. Correa recently notified the Director General of the need to resign from the Committee effective July 1, 2001. Mrs. Thompson and Mr. Ebbitt continue on the Committee.) Since our last report, the Chairman of the Committee, James R. Ebbitt, visited the Cooperation Agency in Brazil from May 13-15, 2001 and with Jocelyn Thompson met in Miami from May 16-19, 2001 with Officials of the Inter-American Institute for Cooperation on Agriculture (IICA) and the external auditors from the firm of Deloitte and Touche which performed the audit of the financial statements of IICA for the period ending December 31, 2000. We visited Brazil at the request of the Director General of IICA to review the implementation phase of the new computer system called BAAN. We visited with IICA Officials and the external auditors in Miami to receive and discuss the audit report for the year ended December 31, 2000.

The Audit Review Committee would like to thank the Director General for the tremendous support he has given the Committee. Without his strong backing and continued support, the work of the Committee would not be as effective and the achievements in transparency and accountability that have been made, may not have been achieved.

AUDIT REVIEW COMMITTEE ACTIVITIES

BAAN System in Brazil

Our primary purpose in visiting Brazil, at the invitation of the Director General, was to review the implementation of the BAAN computer system. The Cooperation Agency in Brazil began the implementation of BAAN with parallel testing in December 1999, began full input of data into BAAN in January 2000, and completed the interface with the old system in July 2000. The Cooperation Agency in Brazil was in the final phases of implementing the system at the time of our visit. Successful implementation there was critical due to the size of the Cooperation Agency in Brazil and also because IICA has made the decision and has begun installation of BAAN at Headquarters in San Jose, Costa Rica as well as at other Cooperation Agencies in other Countries. The BAAN system will be the primary accounting and management information system for IICA when successful implementation is completed. Jesus Moreno, Director of Finance, and Karen Kleinheinz, Controller, accompanied audit Review Committee Chairman Ebbitt to Brazil.

We need to point out that the purpose of the ARC's visit to Brazil was not intended to be an audit of BAAN nor did we spend sufficient time there to perform an audit. However, we were able to determine that BAAN had been successfully implemented from the users point of view both at the Cooperation agency in Brazil and IICA headquarters through interviews of the Regional Director, the Representative and staff from the Cooperation Agency, and the Director of Finance and Controller for IICA, as well as observation and review of

documents produced from the BAAN system. Additionally, the external auditors in performing their audit of financial data for the year ended 2000, sampled transactions from the BAAN system and were able to confirm those transactions.

We were also informed of a number of other beneficial aspects of the BAAN system including the end of required duplicate data entry necessary under previously existing systems; and, the ability to share data quickly with IICA cooperating partners by giving those partners the ability to read information about their projects on-line with the BAAN system. The latter benefit of being able to share information with cooperating partners quickly was noted as a critical improvement over previous systems and allows efficiencies at both the Cooperation Agency and cooperating partners of IICA.

We would like to thank the Regional Director and Representative and Staff of the Cooperation Agency for the excellent cooperation and many courtesies extended to us during our visit as well as to the Director of Finance and staff for arranging the visit.

Visit of the ARC to the Cooperation Agency in Panama

On July 23 and 24, 2001, the Audit Review Committee accompanied by the Director of Finance visited the Cooperation Agency in Panama City, Panama. The purpose of our visit there was to meet with the Representative of Panama, Clara Solis and the Cooperation agency staff and to discuss the on-going work of IICA in Panama. The representative provided information on the background of the Agency in Panama, the present status of operations, and also briefed us on the work of the International Center for Rural Development (CIDER). We also had a meeting with the Minister of Agricultural Development, and received a briefing on the Agricultural Services Modernization Program (PROMOSA).

These meetings allowed the Committee to get a very clear understanding of the tremendous progress that has been made at this Cooperation Agency over the last two years. Much progress was achieved in both transparency of operations and in the establishment of internal controls over program operations. Additionally, the Minister of Agricultural Development also spoke very favorably of the trust and the very effective relationship that has been developed between the Ministry and the Cooperation Agency in Panama. Finally, the Cooperation Agency explained the operations of the first initiative in decentralization in one of the areas of concentration of IICA, Rural Development. The Audit Review Committee would like to thank the Representative and Staff of the Cooperation Agency for the excellent presentations and many courtesies extended to us during our visit.

EXECUTIVE SUMMARY OF AUDIT REVIEW COMMITTEE OBSERVATIONS

According to the Statute of the Audit Review Committee, the Committee's only reporting mandate is to call to the attention of the Executive Committee and the Inter-American Board of Agriculture, anything that in its judgment may constitute a violation of the rules of procedure governing the operation of the General Directorate. Based on our work, we have found no instances nor do we have any indication of violations of the rules of procedure.

We have also reviewed the External Auditor's Report for the comparative financial statements for 2000 and 1999 and their Management Letter accompanying that report. We met with the Audit Partner and audit staff of Deloitte & Touche (the External Auditor) and are pleased to report that we find the work performed by the External Auditor to be thorough and in accordance with the rules of procedure of IICA and international standards on auditing. The External Auditor reports that:

"The financial statements of IICA have been prepared in conformity with generally accepted accounting principles, except for the recognition of US\$1,297,081 as expenses of the period which corresponds to purchase commitments of goods and services not yet received as of December 31, 2000. This accounting practice is based on the regulations of the Inter-American Board of Agriculture and is incorporated into the Rules of the General Directorate, as indicated in Note 1-1." (The note referred to is on page 10 and 11 of the audit report.)

"In our opinion, except for the effects of the matter discussed in the above paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of IICA as of December 31, 2000, and the results of its activities, changes in net assets, and cash flows for the year then ended, in conformity with generally accepted accounting principles."

OBSERVATIONS

1. **Purchase Commitments (Closing Obligations)** - The External Auditor in Note 1-L on Page 10 of the Financial Statement Audit Report notes that IICA follows the practice of recognizing a liability in its financial statements for those commitments assumed during the year to acquire good and services and that at year-end have not yet been received. The External Auditor reports that this practice is in conformity with the Rules of the General Directorate and its Financial Regulations. While the General Directorate has approved this practice, it leads to a qualification on IICA's financial statements as noted above. The External Auditor in commenting on the financial statements of IICA reports that: "In our opinion, except for the effects of the matter discussed in the above paragraph (referring to purchase commitments) the financial position of IICA as of December 31, 2000, and the results of activities, changes in net assets, and cash flows for the year then ended, in

conformity with generally accepted accounting principles." This means that in the opinion of the External Auditor that except for the manner in which IICA handles purchase commitments, IICA follows Generally Accepted Accounting Principles and the External Auditor was able to certify the reports of IICA regarding its financial position except for the purchase commitments amount. As of December 31, 2000, IICA had U.S.\$1,297,081 in purchase commitments outstanding, of which 87 percent is funded through the quota budget.

This issue, Purchase Commitments (Closing Obligations), has been discussed in previous audit reports and prevents the External Auditor from being able to provide a "clean" opinion on IICA's financial statements. Although IICA's rules approved by the IABA allow for Purchase Commitments to be handled in the manner that they are, there is a danger of misuse or inefficient use of funds if commitments are made at year end without a high degree of certainty of realization or if they are not in accordance with approved quota budgets.

In an effort to control this sensitive issue, the Director General took strong action in September 1999 with a letter to IICA operating units which provided guidance and caution on year-end expenditures. The Director General also issued follow-up letters in October and December 1999. These letters established guidance and also created a review committee to look at purchase commitments being made. As a result, improvements have been made and purchase commitments at year-end have been reduced from U.S.\$2.8 million in 1999 to U.S.\$1.2 million in 2000.

The ARC believes that the strong guidance provided by the Director General and oversight by the Deputy Director General, the Director of Programming and Evaluation, and the Director of Finance should be continued so that IICA can eventually attain an unqualified (clean) opinion on its financial statements and gain greater assurance in its financial procedures.

2. **Internal Audit** – The ARC would like to recognize the continued high quality work of the Internal Audit Unit within IICA. During 2000, the Internal Auditor completed work on an Audit Procedures Manual that will guide the work of the Internal Audit staff. The ARC reviewed and commented on and complimented the Internal Auditor for the comprehensive guide that was developed.

Internal Audit is a critical component of any institution and in one as decentralized as IICA, it is even more important. For this reason, the ARC believes that IICA should consider ways of strengthening its already strong Internal Audit Unit. Two issues that need to be addressed are: How to get sufficient audit coverage at the decentralized Cooperating Agencies of IICA; and, how to provide sufficient audit coverage over the highly complex and sophisticated automated and information technology systems utilized by IICA. This latter issue especially is an issue that requires attention as IICA expands its use of sophisticated information technology systems. Some alternatives that IICA may want to consider include: Expanding the size of the Internal Audit Unit; providing training in sophisticated information technology systems to existing staff; or supplementing current staff with contractor provided specialists with expertise in information technology systems;

and the establishment of Regional Controller positions. If IICA continues to grow in its non-quota budget, the need for an expanded role of the Internal Auditor will expand accordingly.

The ARC recommends that this issue be discussed within the Committee on Internal Audit Coordination and that recommendations be developed and brought forward to the Director General and the General Directorate for their consideration.

3. **Disaster Recovery Plan** – In our last report, we noted that the previous External Auditor had expressed a concern that IICA has not clearly outlined a plan to allow for continuing operations in the event of massive damage to computer servers. In the current year end Management Letter, the External Auditor reports that IICA has defined guidelines for the availability of internal and external data back-ups, which would permit it to restore data and application systems in case of a disaster. However, the External Auditor again expresses concern that IICA does not yet have a Disaster Recovery Plan addressing the standards, procedures and measures needed to assure availability of electronic data and continuity of operations, in case of major failure of its technological infrastructure. The External Auditor notes that this is particularly important as IICA implements the new BAAN system.

The ARC recommends that IICA give this issue priority consideration.

4. **Directorate of Finance** – The ARC would like to recognize the strong support and cooperation of the entire Directorate of Finance. This year the Consortium of Corporate Services led the installation of BAAN in Headquarters, which is still in process. This project required additional effort from personnel throughout the Consortium, as well as from personnel from the other Consortiums. It also provided new challenges to the Directorate of Finance as the BAAN system was being implemented and caused changes in the accounting systems and methodologies used to compile the financial statements. Some members of the staff were dedicated to the implementation of BAAN and thus were not available for their regular duties. This caused these responsibilities to fall to the remaining members of this Directorate who all worked extra hours with great dedication to perform their duties. We would also like to recognize those units in Cooperating Agencies who were implementing the BAAN system, especially in Brazil, as they too worked with extra effort and tremendous dedication to support the implementation effort. The Directorate of Finance supports the ARC in a very critical way and without their excellent cooperation and support, the work of the ARC would be made more difficult.

Jocelyn Thompson

James R. Ebbitt