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AUDIT OF THE OVERHEAD RATE  
OF THE CENTRAL AMERICAN INSTITUTE  
FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA  
PROJECT NOS. 596-0089 AND 596-0095

Audit Report No. 1-596-89-36-N  
July 14, 1989

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

TELEPHONES:  
32-9987  
also 32-3120 EXT. 2701-2703

July 14, 1989

MEMORANDUM

TO : ROCAP/Guatemala, Director, Nadine Hogan  
FROM : RIG/A/T, *Coinage N. Gothard* Coinage N. Gothard, Jr.  
SUBJECT: Audit Report No. 1-596-89-36-N, "Audit of the Overhead Rate of the Central American Institute for Industrial Research and Technology"

This report presents the results of a non-Federal financial audit requested by your Mission of the overhead rates applied by the Central American Institute for Industrial Research and Technology (ICAITI) to the Fuelwood and Alternative Energy Sources Project and the Regional Industrial Energy Efficiency Project, ROCAP/Guatemala project Nos. 596-0089 and 596-0095 respectively, during the 30-month period ended June 30, 1988. The certified public accounting firm of Price Waterhouse in Guatemala prepared the report which is dated July 11, 1989.

The purpose of this audit was to determine fair and equitable overhead rates for project Nos. 596-0089 and 596-0095 and a provisional overhead rate for a new project to be started in 1988 and to evaluate the adequacy of the entity's internal control system as it related to overhead rates and its compliance with agreement terms and applicable laws and regulations.

Using the criteria and methodology for determining the overhead rate that was specified in the respective grant agreements Price Waterhouse recommended final overhead rates for project Nos. 596-0089 and 596-0095 of zero percent for 1986 and 4.53 percent for 1987. Its review of operations for the first six months of 1988 did not provide it with sufficient basis to calculate an overhead rate for 1988. Therefore it recommended that a zero overhead rate be applied as a provisional overhead rate to A.I.D. projects during 1988 with an actual overhead rate to be determined at the end of the year and applied retroactively for the whole year as required by the agreements.

Price Waterhouse considered ICAITI's internal controls related to project activities to be adequate except for inaccurate reporting of certain salary expenses incurred outside Guatemala. Also, it considered that

ICAITI has complied with applicable laws and regulations. Regarding ICAITI's compliance with the terms of the agreements, Price Waterhouse found that ICAITI had failed to account for its quotas from Central American Governments in accordance with generally accepted accounting principles, had not determined actual overhead rates on an annual basis as required, and had charged certain questionable costs to the projects.

In its calculation of ICAITI's overhead rates for 1986 and 1987, Price Waterhouse questioned \$692,905 of charges to project Nos. 596-0089 and 596-0095 as well as an undetermined amount of unallowable value-added taxes that were charged and rebates which were received in the purchase of airplane tickets which had not been offset against related costs. The \$692,905 of questioned costs consisted of \$498,908 of excess overhead charged to the projects during 1986 and 1987 and \$193,997 of direct and indirect costs (shown on schedule III of the attached report) which the auditors considered were clearly unallowable or should be suspended because they were not properly supported.

The Price Waterhouse report contains five recommendations concerning ICAITI's overhead rates, internal accounting controls, and compliance with agreement terms. We believe the Price Waterhouse findings are significant and the recommendations should be implemented. The following two recommendations will be included in the Office of the Inspector General's audit recommendation follow-up system:

Recommendation No. 1

We recommend that ROCAP/Guatemala:

- a. negotiate and finalize overhead rates with the Central American Institute for Industrial Research and Technology for ROCAP/Guatemala project Nos. 596-0089 and 596-0095 for 1986 and 1987 based on the recommended rates of zero percent and 4.53 percent, respectively, as stated in the Price Waterhouse report dated July 11, 1989. This would result in the Central American Institute for Industrial Research and Technology refunding \$498,908 of excess overhead charges for those years as identified in the Price Waterhouse report;
- b. apply a provisional overhead rate of zero percent to those ROCAP/Guatemala projects with the Central American Institute for Industrial Research and Technology during 1988, pending a determination of the actual overhead rate; and
- c. assure that the actual overhead rates are determined annually for all projects on which ROCAP/Guatemala allows overhead charges.

Recommendation No. 2

We recommend that ROCAP/Guatemala:

- a. negotiate a settlement with the Central American Institute for Industrial Research and Technology of the \$193,997 in costs

questioned by Price Waterhouse in its report dated July 11, 1989, which were in addition to the amount of questioned overhead costs. In this regard, we note that ROCAP/Guatemala has already taken action to recover \$169,304 of rebates and income that the institution received but did not offset against other project costs; and

- b. determine the amount of value added taxes charged and the amount of airline ticket rebates not properly credited to project Nos. 596-0089 and 596-0095 by the Central American Institute for Industrial Research and Technology and recover the amounts.

The Price Waterhouse report was discussed with ICAITI and with representatives from ROCAP/Guatemala on April 4, 1989 and appropriate changes were made to the final report.

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

AUDIT OF THE OVERHEAD RATE  
OF THE CENTRAL AMERICAN INSTITUTE  
FOR INDUSTRIAL RESEARCH AND TECHNOLOGY (ICAITI)  
ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095

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**AUDIT OF THE OVERHEAD RATE**  
**OF THE CENTRAL AMERICAN INSTITUTE**  
**FOR INDUSTRIAL RESEARCH AND TECHNOLOGY (ICAITI)**  
**ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095**

**TABLE OF CONTENTS**

	<b><u>PAGE</u></b>
<b>Transmittal Letter and Summary</b>	
Background	1 - 2
Audit objectives and scope	2 - 3
Results of audit	3 - 4
Management comments	4 - 5
<b>Report on Overhead Rates</b>	
Auditor's opinion	6
Distribution of operating expenses and determination of the overhead rates for 1986 and 1987	7
Quotas and miscellaneous income applied to fund programs and/or indirect costs	8
Summary of budgeted, actual and questionable costs for 1986, 1987 and for the six months ended June 30, 1988	9 - 11
Findings	12 - 14
<b>Internal Accounting Controls</b>	
Auditor's opinion	15 - 16
Findings	17
<b>Compliance with Agreement Terms and Applicable Laws and Regulations</b>	
Auditor's opinion	18
Findings	19 - 20
<b>List of Report Recommendations</b>	21 - 22

## *Price Waterhouse*

July 11, 1989

Mr. Coinage N. Gothard, Jr.  
Regional Inspector General for Audit  
U.S. Agency for International Development  
Tegucigalpa, Honduras C. A.

Dear Mr. Gothard:

This report presents the results of our audit of the overhead rates of the Central American Institute for Industrial Research and Technology (Instituto Centroamericano de Investigación y Tecnología Industrial, ICAITI) for the 30-month period ended June 30, 1988.

### BACKGROUND

The Central American Institute for Industrial Research and Technology (ICAITI) is an independent nonprofit organization founded by the Governments of Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica to fill the need for an applied research institution in Central America.

ICAITI has made significant contributions to the industrial development of the region, providing technological assistance to Central America's industry and cooperating with the regional authorities and manufacturers in the planning, expansion and development of a broad range of projects.

On June 23, 1988, the Regional Office for Central American Programs in Guatemala (ROCAP/Guatemala) and ICAITI entered into Cooperative Agreement No. 596-0128, "Resources for Industrial Development". The purposes of this agreement were to improve the institutional capability of ICAITI to carry out strategic planning oriented towards improving institutional performance and financial security, and to support ICAITI's efforts to assess industrial needs and to train personnel in priority areas in response to those needs. Special emphasis was to be given to the establishment of internal procedures and mechanisms to permit ICAITI to increase services to its clientele while recovering costs. The estimated budget to be contributed by ROCAP/Guatemala for the two-year life of the project was US\$1,370,000 as detailed in the following page:

<u>Budget Category</u>	<u>Amount</u>
1. Personnel	US\$ 698,000
2. Training	200,000
3. Commodities	75,000
4. Other Direct Costs	<u>81,000</u>
	1,054,000
5. Overhead (estimated at 30% of \$1,054,000)	<u>316,000</u>
Total	<u><u>US\$1,370,000</u></u>

In prior years ICAITI received financial assistance through ROCAP/Guatemala Project Nos. 596-0089 and 596-0095.

The purposes of Project No. 596-0089, "Fuelwood and Alternative Energy Sources" were: a) to test fast growing trees and shrubs and alternative patterns for their production for use as fuel, and b) to test and provide new and improved energy efficient technologies for use in rural homes and communities and by small and medium industry. The project assistance completion date (PACD) was December 31, 1987.

Project No. 596-0095, "Regional Industrial Energy Efficiency", was designed to support a regional effort within Central America and Panama to improve energy efficiency in industry and to reduce industrial consumption of imported petroleum by introducing energy audits, conservation measures, and energy-efficient machinery. The PACD for this project was December 31, 1988.

A provisional overhead rate of 30% of direct costs was approved for both projects, based upon the recommendation of a contractor study (Development Technologies, Inc.). The study, dated July 1, 1985, arrived at this figure using criteria which was incorporated into both grant agreements by project implementation letters.

#### AUDIT OBJECTIVES AND SCOPE -

The objectives of this financial and compliance audit of the overhead rates of the Central American Institute for Industrial Research and Technology (ICAITI) were to determine:

- a) fair and equitable overhead rates for Project Nos. 596-0089 and 596-0095 for the fiscal years ended December 31, 1986 and 1987, and the six-month period ended June 30, 1988, identifying questionable direct and indirect costs, if any, and a provisional overhead rate for Project No. 596-0128;
- b) the adequacy of ICAITI's internal control system, as it relates to overhead rates, to record transactions under the projects; and

- c) ICAITI's compliance with agreement terms and applicable laws and regulations.

Our examination was performed in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision), and applicable guidelines included in OMB Circular A-122, "Cost Principles for Nonprofit Organizations", and the project grant Standard Provisions.

The scope of our work included:

- Reviewing ICAITI direct and indirect costs for the fiscal years ended December 31, 1986 and 1987 and the six-month period ended June 30, 1988.
- Applying the criteria contained in OMB Circular A-122 to determine allowable direct and indirect costs, and the criteria contained in the Project Grant Agreement Nos. 596-0089 and 596-0095 for allocating overhead for each period under review.
- Reviewing the accounting and administrative control systems of ICAITI with emphasis on those procedures and practices applied in recording project activities.
- Reviewing ICAITI's compliance with agreement terms and applicable laws and regulations.

During our work we were alert to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts.

## RESULTS OF AUDIT

### Overhead Rates

Since the grant agreements indicated that ICAITI'S Government quotas and miscellaneous income would be fully applied toward funding programs and/or indirect costs of the organization with no provision for building up its accumulated surplus, we have determined that the overhead rate applied to Project Nos. 596-0089 and 596-0095 should be zero for 1986 and 4.53% for 1987. Our review of operations for the first six months of 1988 provided insufficient basis to calculate an overhead rate for 1988. Therefore, the essentially zero rate for the prior two years would also apply to Project No. 596-0095 which continued during 1988 and to Project 596-0128 which started in 1988. However, the actual overhead rate should be determined at the end of 1988 and applied retroactively for the whole year, as required by the agreement.

Internal Control -

The internal accounting and administrative control systems of ICAITI related to project activities are considered adequate, except that reimbursement requests submitted to ROCAP/Guatemala were not accurate in regard to salaries of certain employees working outside of Guatemala on Project No. 596-0095.

Compliance with Agreement Terms and Applicable Laws and Regulations -

ICAITI complied with agreement terms and with laws and regulations applicable to an institution of its nature, except that revenues from Government quotas were not accounted for in accordance with generally accepted accounting principles, actual overhead rates were not determined on an annual basis, and questionable costs were charged to the projects.

MANAGEMENT COMMENTS -

This report was discussed with ICAITI and ROCAP/Guatemala representatives, on April 4, 1989. Additional explanations and/or evidence regarding certain costs initially questioned were provided and, where appropriate, changes have been incorporated into this report.

On May 18, 1989, we requested that ICAITI and ROCAP provide written comments by June 7, 1989. However, as of the date of this report, none had been provided.

Unofficially, ROCAP expressed that the audit conducted was based upon invalid assumptions and an overly simplistic methodology which did not take into account A.I.D. policies and regulations as reflected in OMB Circular A-122, and that the findings and recommendations which resulted were unacceptable and inconsistent with past and present U.S. Government policy.

The main point that ROCAP objected to was our contention that the Development Technologies Inc. study, which was incorporated into the agreements by project implementation letters, called for applying ICAITI's income from Government quotas and miscellaneous sources to fund its programs and/or indirect costs, with no provision to accumulate surplus or over-recover total costs.

ROCAP expressed that the study report did not literally state that there would be no provision to accumulate surplus or to over-recover total costs; and that ROCAP had made a mistake to have incorporated the criteria from the above mentioned study into the agreements, since these criteria were not in compliance with A.I.D. policies and regulations detailed in OMB Circular A-122.

ROCAP also expressed that neither ROCAP nor ICAITI intended that member Government quotas be applied to defray the overhead expenses of ROCAP projects. It expressed that present U.S. Government policy reflected in the current ROCAP project with ICAITI is to promote the institution's long-term financial viability and the sustainable provision of priority services to the export sector in Central America. To require the institution to repay the amounts questioned in the audit would run counter to such policy.

We believe that our interpretation of the Development Technologies Inc. study was reasonable. The study's narrative and illustrative budgets indicated that ICAITI's member state Government quotas and miscellaneous income would be applied to fund its programs and/or indirect costs, and the budgets illustrating the resulting overhead calculations do not show any of the Government quotas and miscellaneous income being applied to accumulate surplus. Further, we do not see any issue with regard to the study criteria not being in compliance with OMB Circular A-122 cost principles. To require the grantee to apply its Government quotas and miscellaneous income to fund its programs and/or indirect costs is not a matter of cost principles but rather a matter of specifying the terms of the agreement, which would be within ROCAP's discretion. Such a provision would appear to have been designed to motivate ICAITI to apply its Government quotas and miscellaneous income to an expanded program base since the alternative would be to fund its overhead.

We do agree that recovering from ICAITI the amount overcharged for overhead will have a negative effect on its financial strength. However, as indicated in the related audit finding, ICAITI's cash receipts for 1986 and 1987 exceeded its disbursements by about \$708,000 or \$209,000 more than the amount of the overcharge for those years. At December 31, 1987, ICAITI had cash balances more than sufficient to repay the overcharge. Additionally, it had Government quotas receivable amounting to approximately \$4.0 million.

*Price Waterhouse*

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON OVERHEAD RATES

AUDITOR'S OPINION

We have performed a financial and compliance audit of the overhead rates and the related methodology applied by the Central American Institute for Industrial Research and Technology (ICAITI) to the "Fuelwood and Alternative Energy Sources" and the "Regional Industrial Energy Efficiency" projects, ROCAP/Guatemala Project Nos. 596-0089 and 596-0095 for the 30-month period ended June 30, 1988. Our examination was performed in accordance with generally accepted auditing standards, the United States Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision), and the general guidelines for computing overhead rates provided by Grant Agreement Nos. 596-0089 and 596-0095. A summary of budgeted, actual and questionable costs is presented as Schedule III in page 9.

Accordingly, we recommend that the final overhead rate for Project Nos. 596-0089 and 596-0095 should be zero for fiscal year 1986 and 4.53% for 1987. The actual overhead rate for 1988 should be determined at year end and applied retroactively to the whole year, as required by the Grant Agreements. The new ROCAP/Guatemala Project No. 596-0128 should include a provisional overhead rate of zero and be reviewed at the end of each year to establish a final acceptable rate.

This report is intended solely for the use of ICAITI and the United States Agency for International Development (A.I.D.). This restriction is not intended to limit distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.



Guatemala, December 23, 1988

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
 ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095  
 REPORT ON OVERHEAD RATES

DISTRIBUTION OF OPERATING EXPENSES AND DETERMINATION OF OVERHEAD RATES  
 (expressed in U. S. Dollars)

	1986		1987	
<u>Operating Costs</u>	<u>Overhead</u>	<u>Direct Costs</u>	<u>Overhead</u>	<u>Direct Costs</u>
Personal services	\$ 356,827	\$ 797,139	\$ 458,705	\$ 950,214
Materials and supplies	12,271	136,109	21,005	114,309
Other costs and services	<u>190,366</u>	<u>562,686</u>	<u>178,700</u>	<u>463,264</u>
Total operating costs	559,464	1,495,934	658,410	1,527,787
Overhead reclassification -				
Equipment purchases		(63,897)		(58,305)
Other reclassifications	<u>5,450</u>	<u>(5,450)(1)</u>	<u>1,441</u>	<u>(1,441)(2)</u>
Adjusted operating costs	564,914	<u>\$1,426,567</u>	659,851	<u>\$1,468,041</u>
<u>Government Quotas and Miscellaneous Income</u>				
Governments Quotas				
Ordinary	400,000		400,000	
Extraordinary	375,000		375,000	
Other income	<u>80,083</u>		<u>34,804</u>	
Total	855,083		809,804	
Amount applied to fund programs and/or indirect costs (schedule II, page 8)	<u>(73,386)</u>		<u>(216,459)</u>	
Quotas and miscellaneous income not applied to expenses	<u>781,697</u>		<u>593,345</u>	
Excess of overhead over unapplied quotas and miscellaneous income (non-covered overhead)	<u>\$ (216,783)</u>		<u>\$ 66,506</u>	
<u>Overhead absorption</u>				
Non-covered overhead	<u>\$ (216,783)</u>		<u>\$ 66,506</u>	
Total direct costs	\$1,426,587		\$1,468,041	
	= -15.20%		= 4.53%	

- (1) Covering sundry materials and supplies, which are questionable as they pertain to reclassification entries for budget deficiencies.
- (2) See explanation in page 10, item 1a.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON OVERHEAD RATES

QUOTAS AND MISCELLANEOUS INCOME APPLIED  
TO FUND PROGRAMS AND/OR INDIRECT COSTS

	<u>1986</u>		<u>1987</u>	
Capital surplus as of January 1	\$1,222,037	(1)	\$1,537,389	(1)
Excess of cash receipts over disbursements	315,352	(1)	392,854	(1)
Exchange differences reported as prior period adjustments	_____	(1)	(225,864)	(1)
Capital surplus as of December 31	<u>\$1,537,389</u>	(1)	<u>\$1,704,379</u>	(1)
Excess of cash receipts over disbursements	315,352	(1)	392,854	(1)
Quotas from member states and miscellaneous income (cash basis)	<u>388,738</u>	(1)	<u>609,313</u>	(1)
Quotas and miscellaneous income applied to fund programs and/ or indirect costs	<u>\$ 73,386</u>		<u>\$ 216,459</u>	

(1) From ICAITI's audited financial statements.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
 ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095

Schedule III

REPORT ON OVERHEAD RATES

SUMMARY OF BUDGETED, ACTUAL AND QUESTIONABLE COSTS  
 FOR THE YEARS ENDED DECEMBER 31, 1986, 1987 AND THE SIX MONTHS TO JUNE 30, 1988

Item	Total Budgeted	Accumulated	Actual	Actual	Six months end	Total	Questioned and suspended	Explanation of Questioned and suspended Costs (Attached)
		At December 31, 1985	1986	1987	June 30, 1988			
-----								
(*)								
GRANT AGREEMENT No. 596-0089								
FUELWOOD AND ALTERNATIVE ENERGY SOURCES								
-----								
PERSONAL SERVICES	2,113,000	1,546,484	177,563	482,504		2,206,551	3,730	1a, 1b
MATERIALS AND SUPPLIES	419,000	317,704	38,275	50,740		406,719		
OTHER DIRECT COSTS	839,650	696,903	135,363	(35,177)(1)		797,089		
-----								
TOTAL DIRECT COSTS	3,371,650	2,561,091	351,201	498,067		3,410,359		
OVERHEAD	1,168,000	875,088	106,148	148,055		1,129,291	231,641 (2)	2 6
-----								
TOTAL	4,539,650	3,436,179	457,349	646,122		4,539,650		
=====								
PROJECT No. 596-0095								
REGIONAL INDUSTRIAL ENERGY EFFICIENCY								
-----								
PERSONAL SERVICES	2,537,803	1,700,248	208,797	296,083	187,080	2,392,208	20,963	3
MATERIALS AND SUPPLIES	136,962	42,471	25,218	43,317	8,343	119,349		
OTHER DIRECT COSTS	1,131,181	543,869	217,733	193,834	70,230	1,025,666		
-----								
TOTAL DIRECT COSTS	3,805,946	2,286,588	451,748	533,234	265,653	3,537,223		
OVERHEAD	500,092	113,233	137,648	153,775	78,952	483,608	267,267	4
-----								
INCOME FROM SEMINARS							169,304 (2)	5 6
-----								
TOTAL	4,306,038	2,399,821	589,396	687,009	344,605	4,020,831		
=====								

\* Audited by the accounting firm of Praun Reyes Aldana & Asociados.

- (1) Net effect of adjustment resulting from the reconciliation of balances between ROCAP and ICAITI  
 (2) Value-added taxes and cash rebates in the purchase of airplane tickets whose total value has to be determined by ICAITI.

AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095

EXPLANATION OF QUESTIONABLE COSTS FOR THE  
YEARS ENDED DECEMBER 31, 1986 AND 1987  
(expressed in U.S. dollars)

<u>REFERENCE</u>	<u>DETAIL</u>	<u>AMOUNT</u>	
		<u>Questioned</u>	<u>(1) Suspense</u>

Project No. 596-0089

1 a	Fees paid to Consultores Prada for the implementation of a salary system not allowable as a project direct cost since it covered ICAITI as a whole.	\$	1,441
1 b	Exchange differences arising from the conversion to U. S. dollars, of the severance compensation paid to Messrs L. Arce and A. Rodríguez, improperly charged to ROCAP/Guatemala.	\$	2,289
2	Overhead calculated in 1986 and 1987 as follows:		
	1986 \$351,201 x(15.20%)		
	1987 \$498,067 x 4.53%	\$	22,562
			22,562
	Charged by ICAITI (Schedule III)	\$	254,203
		\$	231,641

Project No. 596-0095

3	Salary adjustments which lack appropriate supporting documentation or result from accounting errors (journal entries 179 and 184 of June, 1988).	\$	20,963
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(1) We consider these costs to be clearly unallowable or resolved

REFERENCE

DETAIL

AMOUNT

Project No. 596-0095

Questioned      Suspense

4	Overhead calculated in 1986, 1987 and the six-month period to June 30, 1988 as follows:		
	1986 \$451,748 x (15.20%)		
	1987 \$533,234 x 4.53%	\$ 24,156	
	1988 \$265,653 x 0.00%	<u>                    </u>	(1)
		\$ 24,156	
	Charged by ICAITI (Schedule III)	<u>\$ 291,423</u>	\$ 267,267

5            Rebates and income received for energy audits and seminars not offset against the related direct costs charged to ROCAP. \$ 169,304

This matter was settled by ROCAP subsequent to our review. PIL No. 56 of March 3, 1989 authorized ICAITI to use these funds in establishing a trust fund.

Project Nos. 596-0089 and 596-0095

6.            Value-added taxes and rebates received in the purchase of airplane tickets not offset against the related costs. These values have to be quantified by ICAITI. to be determined

(1)            Tentative calculation; actual overhead rate for 1988 needs to be determined.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095

REPORT ON OVERHEAD RATES

FINDINGS

1. Overhead Charged to the Projects Was Excessive

Condition:

Using the methodology for calculating overhead established in Grant Agreement Nos. 596-0089 and 596-0095, and generally accepted accounting principles, also required by these agreements, we determined that the overhead rates charged by ICAITI to ROCAP'S projects were excessive (see schedule III on page 9).

Criteria:

With regard to the methodology for charging overhead, the contractor study which was incorporated into Grant Agreement Nos. 596-0089 and 596-0095 by reference thereto, established the ground rules in this area. The contractor study indicated that ICAITI would: (1) reclassify certain of its costs previously considered to be indirect costs to the direct cost category, and (2) apply its income from Government quotas and miscellaneous sources to fund programs and/or indirect costs, with no provision to accumulate surplus or over-recover total costs.

The grant agreements also required that ICAITI account for its operations under generally accepted accounting principles (GAAP) which would require accounting for its Government quotas on an accrual basis. The methodology used in the above mentioned study can be applied under any basis of accounting. While we did note that the overhead rate recommended in the study accounted for Government quotas on a cash basis, our calculations are based upon including the income from Government quotas when earned, in accordance with GAAP and the terms of the agreements.

Cause:

The excessive overhead rates that ICAITI used in charging the projects are the result of charging the overhead rate recommended by the above mentioned study throughout the audit period without adjustment, even though the grant agreements provided for determining actual overhead rates at the end of each year using the criteria outlined in the study.

Effect:

ICAITI overcharged ROCAP \$498,908 for overhead during 1986 and 1987. Also, during the same period, ICAITI cash receipts exceeded disbursements by \$708,206 (See Schedule II on page 8).

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089 AND 596-0095

REPORT ON OVERHEAD RATES

FINDINGS

Recommendation:

ROCAP/Guatemala should require ICAITI to refund its excess overhead recoveries on Project Nos. 596-0089 and 596-0095.

2. Revenues from Government Quotas Were not Recorded in Accordance With Generally Accepted Accounting Principles

Condition:

ICAITI accounts for its revenues on an accrual basis, except for both the ordinary and extraordinary contributions from the Central American Governments which are recognized when collected. As of June 30, 1988, ICAITI had recorded approximately US\$4,350,000 as accounts receivable from Governments which were accrued as "Ordinary and Extraordinary Quotas not Received."

Criteria:

The Grant Agreements require that ICAITI maintain its accounts in conformity with generally accepted accounting principles, which in turn require that revenues be recognized as they accrue. Such recognition should not be deferred since the contributions represent a firm commitment of the Governments.

Cause:

This income recognition system was adopted by ICAITI because the Governments do not pay their contributions on time and it is not feasible to make accurate projections on their collection.

Effect:

ICAITI's results of operations were understated since neither the ordinary (\$400,000 per annum) nor the extraordinary (\$375,000 per annum) contributions were accounted for as income under the accrual method of accounting.

Recommendation:

ROCAP/Guatemala should request ICAITI to consistently adopt generally accepted accounting principles to record its transactions in order to determine an acceptable overhead rate for A.I.D. projects.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON OVERHEAD RATES

FINDINGS

3. Actual Overhead Rates Have not Been Determined on an Annual Basis

Condition:

The 30% provisional overhead rate approved by ROCAP in 1985 has been charged to the projects without making an attempt to determine actual rates.

Criteria:

According to project implementation letters, actual overhead rates should be determined on an annual basis.

Cause:

It appears that ICAITI understood that actual rates were to be determined based on audits ordered by ROCAP.

Effect:

Charges of overhead to the projects were excessive and the corresponding adjustments not recorded on a timely basis.

Recommendation:

ROCAP/Guatemala should require ICAITI to analyze, on an annual basis, the allowability of all direct and indirect costs in order to accurately establish the actual overhead rate to be applied to each agreement. Unallowable direct costs reimbursed by ROCAP/Guatemala should be refunded by ICAITI and unallowable indirect costs should be removed from the overhead pool as regards charges to U.S. Government projects. Also, overhead reimbursed by ROCAP/Guatemala, in excess of the rates determined from actual allowable costs should be refunded by ICAITI.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON INTERNAL ACCOUNTING CONTROL

AUDITOR'S OPINION

We have performed a financial and compliance audit of the overhead rates and the related methodology applied by the Central American Institute for Industrial Research and Technology (Instituto Centroamericano de Investigación y Tecnología Industrial - ICAITI) to ROCAP/Guatemala Project Nos. 596-0089 and 596-0095 for the 30-month period ended June 30, 1988, and have issued our report thereon dated December 23, 1988. As part of our examination we made a study and evaluation of the system of internal accounting control of ICAITI to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and the standards for financial and compliance audits contained in the United States Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) and pursuant to the criteria set forth in the statement of work. Our review was limited to an evaluation of cash receipts and disbursements, purchases, payroll and financial reporting.

The management of ICAITI is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of any system of internal accounting control are to provide management with reasonable, but not absolute, assurance that resources are used in accordance with laws, regulations, and the policies of the organization; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly we do not express an opinion on the system of internal accounting control of ICAITI taken as a whole or on any of the categories of controls identified in the first paragraph. However, based on our study and evaluation, we believe that ICAITI's internal accounting controls related to project activities are adequate for ROCAP/

Guatemala's purposes, except for the conditions described as Finding No. 1 in this report and Finding No.1 in the report on compliance with agreement terms and applicable laws and regulations.

This report is intended solely for the use of ICAITI and the United States Agency for International Development (A.I.D.). This restriction is not intended to limit distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

A handwritten signature in cursive script, reading "Rice W. Westbrook".

Guatemala, December 23, 1988

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON INTERNAL ACCOUNTING CONTROL

AUDIT FINDING

1. Salaries for Employees Working Outside of Guatemala Were not Accurately Included in Reimbursement Requests.

Condition:

The requests for reimbursement submitted by ICAITI to ROCAP/Guatemala for Project No. 596-0095 were not accurate, due to direct salaries being charged that were not in accordance with the time reports submitted by employees working outside of Guatemala.

Some direct salaries charged to ROCAP/Guatemala were for employees whose biweekly time reports did not include time chargeable to the project, while salaries for some employees who, according to their biweekly time reports, actually worked for the project were not included in the reimbursement summary reports.

Criteria:

According to the agreement, adequate control over time charged to the project should be maintained in support of the related salary and compensation charges.

Cause:

The above situation, according to management, was due to errors in the accounting/recording process.

Effect:

As a result of the errors detected, the reasonableness of the direct costs reported to ROCAP/Guatemala was in doubt.

Recommendation:

ROCAP/Guatemala should require ICAITI to analyze the charges for salaries submitted to ROCAP/Guatemala for reimbursement in order to determine the reasonableness of direct project costs.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON COMPLIANCE WITH AGREEMENT TERMS AND  
APPLICABLE LAWS AND REGULATIONS

AUDITOR'S OPINION

We have performed a financial and compliance audit of the overhead rates and the related methodology applied by the Central American Institute for Industrial Research and Technology (Instituto Centroamericano de Investigación y Tecnología Industrial - ICAITI) to ROCAP/Guatemala Project Nos. 596-0089 and No. 596-0095 for the 30-month period ended June 30, 1988, and have issued our report dated December 23, 1988. As part of our examination we selected and tested transactions and records to determine ICAITI's compliance with agreement terms and applicable laws and regulations as required by the standards for compliance and financial audits contained in the United States Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) and pursuant to the criteria set forth in the statement of work.

As mentioned in Finding No. 1 of this report, as of June 30, 1988, ICAITI had received \$169,304 in income for energy audits and seminars related to project execution activities. This income was not credited to or offset against project costs as stipulated in the agreement. ICAITI also received rebates on its airplane ticket purchases which were not credited to project costs, and it had paid value-added taxes to the Government of Guatemala, which are not allowable as project costs under the agreement terms.

In our opinion, except for the conditions described under finding Nos. 2 and 3 in the report on overhead rates and for the questionable costs charged to the project, as explained in schedule III of the report on overhead rates and finding No. 1 of this section, ICAITI complied with agreement terms and applicable laws and regulations related to ROCAP/Guatemala Project Nos. 596-0089 and No. 596-0095 for the 30-month period ended June 30, 1988. Nothing came to our attention that caused us to believe that untested items were not in compliance with agreement terms and applicable laws and regulations.

This report is intended solely for the use of ICAITI and the United States Agency for International Development (A.I.D.). This restriction is not intended to limit distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.



Guatemala, December 23, 1988

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON COMPLIANCE WITH AGREEMENT TERMS AND  
APPLICABLE LAWS AND REGULATIONS

FINDINGS

1. Unallowable Value-Added Taxes Were Charged to the Projects and Certain Rebates and Revenues Received Were not Offset Against Related Direct Expenses.

Condition:

The following situations were revealed by our examination:

- ICAITI was given a 2% rebate by TIVOLI (a travel agency) on its total billings for airplane tickets and said rebate was not credited to the related expense item.
- The direct cost liquidations submitted by ICAITI to ROCAP/Guatemala include a Value-Added Tax (IVA) paid on certain purchases. The taxes, which are not an allowable cost under OMB Circular A-122 guidelines, and specifically excluded by the agreement, have been reimbursed by ROCAP/Guatemala together with overhead.
- ICAITI received \$169,304 in income for an energy audit and a related seminar, as well as from a fuelwood seminar. This income was not credited or offset to project costs as stipulated in the agreement.

Criteria:

According to the agreement terms and the standard provisions, taxes are not allowable costs and any receipts derived from discounts and/or commissions during project execution should be applied to the applicable expense item or reimbursed to the grantor.

Cause:

It appears that ICAITI disregarded the agreement terms in these areas.

Effect:

An unaudited breakdown prepared by ICAITI shows a deferred credit (liability) of \$169,304 corresponding to revenues derived from audits and seminars held during project execution.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

REPORT ON COMPLIANCE WITH AGREEMENT TERMS AND  
APPLICABLE LAWS AND REGULATIONS

FINDINGS

The total IVA reimbursed and the rebates received on airplane ticket billings by ICAITI, which should have been credited to the projects' direct costs, have not been determined. Our limited testing, however, disclosed IVA reimbursements for \$1,320.

Recommendation:

ROCAP/Guatemala should require ICAITI to prepare a schedule showing the total of value-added taxes included in reimbursement vouchers, rebates received on airplane ticket billings, and other income resulting from project activities. The resulting amounts should be credited or offset against related direct expense items reimbursed to ICAITI by ROCAP/Guatemala for Project Nos. 596-0089 and 596-0095 and appropriate adjustments made to overhead charges. Also, in order to fully comply with A.I.D. requirements, ICAITI should implement separate controls to ensure that value-added taxes and/or other taxes it pays are not charged to A.I.D. projects.

CENTRAL AMERICAN INSTITUTE FOR INDUSTRIAL RESEARCH AND TECHNOLOGY  
ROCAP/GUATEMALA PROJECT NOS. 596-0089  
AND 596-0095

LIST OF REPORT RECOMMENDATIONS

Report on overhead rates

Recommendation 1:

ROCAP/Guatemala should require ICAITI to refund its excess overhead recoveries on Project Nos. 596-0089 and 596-0095.

Recommendation 2:

ROCAP/Guatemala should request ICAITI to consistently adopt generally accepted accounting principles to record its transactions in order to determine an acceptable overhead rate for A.I.D. projects.

Recommendation 3:

ROCAP/Guatemala should require ICAITI to analyze, on an annual basis, the allowability of all direct and indirect costs in order to accurately establish the actual overhead rate to be applied to each agreement. Unallowable direct costs reimbursed by ROCAP/Guatemala should be refunded by ICAITI and unallowable indirect costs should be removed from the overhead pool as regards charges to U.S. Government projects. Also, overhead reimbursed by ROCAP/Guatemala, in excess of the rates determined from actual allowable costs should be refunded by ICAITI.

Report on internal controls

Recommendation 1:

ROCAP/Guatemala should require ICAITI to analyze the charges for salaries submitted to ROCAP/Guatemala for reimbursement in order to determine the reasonableness of direct project costs.

Report on compliance with agreement terms and applicable laws and regulations

Recommendation 1:

ROCAP/Guatemala should require ICAITI to prepare a schedule showing the total of value-added taxes included in reimbursement vouchers, rebates received on airplane ticket billings, and other income resulting from project activities. The resulting amounts should be credited or offset against related direct expense items reimbursed to ICAITI by ROCAP/Guatemala for Project Nos. 596-0089 and 596-0095 and appropriate adjustments made to overhead

charges. Also, in order to fully comply with A.I.D. requirements, ICAITI should implement separate controls to ensure that value-added taxes and/or other taxes it pays are not charged to A.I.D. projects.

APPENDIX I

REPORT DISTRIBUTION

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- 23 -