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AUDIT OF
THE RURAL POTABLE WATER AND
SANITATION II PROJECT
WITH THE
WATER FOR THE PEOPLE ASSOCIATION

Audit Report No. 1-520-90-07-N
November 17, 1989

AGENCY FOR INTERNATIONAL DEVELOPMENT

U. S. MAILING ADDRESS:

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November 17, 1989

MEMORANDUM

TO: USAID/Guatemala Director, Anthony J. Caterucci

FROM: RIG/A/T, *Conroy N. Gothard Jr.*

SUBJECT: Audit Report No. 1-520-90-07-N, "Audit of the Rural Potable Water and Sanitation II Project with the Water for the People Association"

This report presents the results of a non-Federal financial audit requested by your Mission of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, with the Water for the People Association (Asociacion Pro-Agua del Pueblo) (the Association). The audit covered the period from the beginning of the project through March 31, 1988. The accounting firm of Peat Marwick in Guatemala prepared the report, which is dated November 6, 1989.

The purpose of the project was to improve environmental sanitation in approximately 62 rural communities in Guatemala through the installation of water systems and latrines and the provision of educational courses in sanitation. Of the US\$1,000,000 in grant funds authorized by USAID/Guatemala for the project about US\$645,000 (Q.1,612,120) had been spent through the end of the audit period.

The objective of this audit was to determine whether: (1) the fund accountability statement for the project fairly presents project receipts and expenditures for the period with disclosure of questionable expenditures, if any; (2) the Association's internal control structure is adequate to manage project funds; and (3) the Association has complied with agreement terms and applicable laws and regulations.

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Peat Marwick disclaimed expressing an opinion on the project's fund accountability statement due to a lack of financial information on the project and inadequate accounting records and considered the entire Q.1,612,120 reported as expended through the end of the audit period as questionable costs because the expenditures were not supported by source documentation. Peat Marwick's study and evaluation of the internal control structure revealed material weaknesses, which were (1) the Association's accounting system did not provide separate accountability for project funds; (2) financial information provided to USAID/Guatemala was based on reimbursement requests instead of accounting records and could not be traced to supporting documentation; (3) project funds were commingled with the Association's own funds; (4) there was no accountability and control over project inventory; (5) there was inadequate control over fixed assets; and (6) the valuation of project inventories was improper. Peat Marwick also disclaimed expressing an opinion on the Association's compliance with agreement terms and applicable laws and regulations because of the material control weaknesses noted above and their negative effect on the reliability of financial information and control of project income and expenditures. Nevertheless, instances of noncompliance were found and consisted of (1) two vehicles were purchased without obtaining USAID/Guatemala authorization, (2) competitive bids were not obtained as required on many procurements, and (3) informational tax returns were not filed as required.

The Peat Marwick report was discussed with representatives from the Association and USAID/Guatemala on October 5, 1989. Association representatives were in general agreement that the report reflected the project conditions at the time of the audit and they stated that they were in the process of implementing some of the recommendations.

The Peat Marwick report contains 9 recommendations regarding improvements needed in the Association's accountability and control over A.I.D. funds and compliance with agreement terms and applicable laws and regulations. However, since the project ended on June 30, 1989, requiring the implementation of specific project related recommendations would be inappropriate unless A.I.D. plans to continue to work with the grantee on further projects. Nevertheless, we are making the following recommendations which will be included in the Office of the Inspector General's audit recommendation follow-up system.

Recommendation No. 1

We recommend that USAID/Guatemala negotiate a settlement with the Water for the People Association concerning the Q.1,612,120 (US\$644,848) in costs considered questionable by the Peat Marwick report dated November 6, 1989.

Recommendation No. 2

We recommend that USAID/Guatemala obtain technical assistance for performing a financial review to determine if the same condition of lack of documentation to support project expenditures persisted from the end of the audit period on March 31, 1988 through the end of the project on June 30, 1989. If so, USAID/Guatemala should negotiate a settlement with the Water for the People Association for the additional project expenditures through the end of the project amounting to as much as US\$355,152 which would also be unsupported and therefore considered questionable.

Recommendation No. 3

We recommend that USAID/Guatemala not enter into any further agreements to award A.I.D. funds to the Water for the People Association until that organization can demonstrate that it has implemented an adequate accounting system and internal controls structure to provide supporting documentation for project expenditures and adequate accountability for A.I.D. funds.

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

**AUDIT OF THE RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

**AUDIT OF THE RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

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Peat Marwick

Certified Public Accountants

P. O. Box 1020
Guatemala, C. A.

November 6, 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 Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, managed by the Water for the People Association for the period from January 1, 1985 through March 31, 1988.

BACKGROUND

On January 1, 1985, the United States Agency for International Development in Guatemala (USAID/Guatemala) and the Water for the People Association (the Association) signed grant agreement No. 520-0335 providing US\$1,000,000 in funding for the Rural Potable Water and Sanitation II Project. For its part, the Association agreed to contribute US\$4,189,546 as counterpart funds. The project was originally scheduled to last three years, but it was extended for an additional year to June 30, 1989.

The project is managed by the Water for the People Association, a nonprofit institution whose administrative offices are located in the department of Quetzaltenango, 210 kilometers from Guatemala city. The purpose of the project was to improve environmental sanitation in approximately 62 rural communities in Guatemala. Sixty two water systems and 8,000 latrines were to be built under the project. Additionally, activities were to be complemented with educational courses in sanitation given to the communities, and to participating private and voluntary organizations.

The budget for the project is as follows:

PROJECT BUDGET

(Expressed in US\$)

	<u>A.I.D.</u>	<u>COUNTERPART</u>	<u>TOTAL</u>
Technical personnel	\$ 277,259	\$ 211,957	\$ 489,216
Administrative personnel	137,987	89,540	227,527
Operating expenses	40,983	26,258	67,241
External audit	9,265	4,385	13,650
Fixed assets	42,500	- - - -	42,500
Contributions	- - -	647,526	647,526
Subprojects	<u>492,006</u>	<u>3,209,880</u>	<u>3,701,886</u>
 TOTAL	 \$ 1,000,000 =====	 \$ 4,189,546 =====	 \$ 5,189,546 =====

AUDIT OBJECTIVES AND SCOPE

We conducted a financial audit of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, implemented by the Water for the People Association (the Association) during the period January 1, 1985 through March 31, 1988.

The objectives of our audit were to determine whether:

1. The fund accountability statement for the Rural Potable Water and Sanitation II Project fairly presents the project's receipts and expenditures through March 31, 1988 in accordance with the terms of the agreement, identifying any costs which are not fully supported with adequate documentation or which are not allowable under the terms of the agreement;
2. The Association's internal control structure is adequate for USAID/Guatemala's purposes; and
3. The Association has complied with the terms of the agreement and with applicable laws and regulations which may have a material effect on the fund accountability statement.

Our examination was performed in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Government Auditing Standards" (1988 Revision).

The scope of our work consisted of:

- reviewing on a selective test basis the documentation supporting project income and expenditures to determine whether the project fund accountability statement presents fairly the project's financial position as of March 31, 1988;
- studying and evaluating the internal control structure of the Association related to project activities;
- reviewing project transactions to determine compliance with agreement terms and applicable laws and regulations;
- reviewing bank reconciliations for income and expenditures related to USAID/Guatemala funds, for determining the validity of recorded transactions; and
- reviewing supporting documentation to determine whether expenditures reported as incurred, were in fact allowable, allocable and reasonable in accordance with the agreement.

During the audit, we were alert to situations or transactions which might indicate fraud, abuse or illegal expenditures or acts.

RESULTS OF AUDIT

1. Fund Accountability Statement

We have disclaimed our opinion on the fund accountability statement of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, for the period from January 1, 1985 to March 31, 1988, due to the lack of financial information on the project and inadequate accounting records. Furthermore, since reported expenditures were not supported with source documentation, we consider the entire Q1,612,120 of expenditures reported through the end of the audit period to be questionable and categorized as suspended costs.

2. Internal Control Structure

Our study and evaluation of the internal control structure established by the Association revealed reportable conditions which we believe are material weaknesses and result in more than a relatively low risk that errors or irregularities which could be material in relation to the project's fund accountability statement may occur and not be detected.

Our evaluation revealed the following findings:

- The accounting system did not provide separate accountability for project funds,

- Financial information sent to USAID/Guatemala was not based on accounting records,
- Project funds were commingled with the Association's own funds,
- There was no accountability and control over project inventory,
- There was inadequate control over fixed assets, and
- The valuation of project inventories was improper.

3. Compliance with Agreement Terms and Applicable Laws and Regulations

The Association does not have reliable financial information related to the project and the subsidiary accounting records for the control of project income and disbursements were inadequate. These conditions prevent us from expressing and we do not express an opinion on compliance with agreement terms and applicable laws and regulations. However, our evaluation revealed the following noncompliance conditions:

- Fixed assets were acquired without USAID/Guatemala authorization;
- The Association had not submitted income tax returns; and
- Purchases did not meet the bidding procedure required by the agreement.

MANAGEMENT COMMENTS

USAID/Guatemala and the Water for the People Association (the Association) received a copy of this report and on October 5 we discussed it with them. Association representatives were in general agreement that the report reflects the project conditions at the time of the audit work, and they stated that they were in the process of implementing some of recommendations.

We told the Association representatives that their written comments would be included in this report if received by October 13, 1989. However, as of the date of this report, no comments had been provided.

Klynveld Peat Marwick Goerdeler



Peat Marwick

Certified Public Accountants

P. O. Box 1020
Guatemala, C. A.

**RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

REPORT ON THE FUND ACCOUNTABILITY STATEMENT

AUDITOR'S OPINION

We have audited the accompanying fund accountability statement of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, managed by the Water for the People Association (the Association) for the period from January 1, 1985 to March 31, 1988. This financial statement is the responsibility of the Association's management. Our responsibility is to express an opinion on this financial statement based on our audit.

Except for what is mentioned in the fourth paragraph below, we conducted our audit in accordance with generally accepted auditing standards and the U.S. Comptroller General's "Government Auditing Standards" (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles and practices used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the fund accountability statement was prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

The accompanying fund accountability statement was prepared from the Association's requests for disbursements sent to USAID/Guatemala since, as is more fully described in findings No. 1 and 2 of the report on the internal accounting control, the Association's accounting system did not provide separate accountability for USAID/Guatemala's funds and files were not maintained identifying the source documentation supporting the Association's reimbursement requests to USAID/Guatemala. In addition, the Association established a bank account for the project; however, as explained in finding No. 3 of the report on internal control structure, some of the funds disbursed by USAID/Guatemala were not deposited in this bank account; funds transferred from it were commingled into the Association's general account; and funds from another USAID/Guatemala project managed by the Association were commingled in it. Therefore, it was not possible to determine whether all the checks issued from this bank account are chargeable to the project. We were not able to apply alternative procedures to verify whether the reports sent to USAID/Guatemala

were supported with source documentation. Therefore, we consider the expenditures reported to USAID/Guatemala amounting to Q1,612,120 to be questionable and categorized as suspended costs.

Because of the matters mentioned in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the fund accountability statement of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, for the period from January 1, 1985 to March 31, 1988.

Klyuvel Pest Warwick Goendeler

February 3, 1989

**RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

FUND ACCOUNTABILITY STATEMENT

For the period from January 1, 1985 to March 31, 1988
(Expressed in Quetzales - Note 4)

INCOME		
Funds provided by USAID/Guatemala		<u>Q 1,614,434</u>
EXPENDITURES		
Technical personnel		Q 271,820
Administrative personnel		149,410
Operating expenses		128,517
External audit		5,000
Fixed assets		256,661
Subprojects		799,572
Consulting		<u>1,140</u>
Computed cash balance		<u>Q 1,612,120</u>
Actual cash balance		<u>Q 2,314</u>
Unreconciled overage (1)		<u>Q 210,814</u>
		Q 208,500 =====

(1) See finding No. 3 of our report of internal accounting controls

**RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

Notes to the Fund Accountability Statement
For the period from January 1, 1985 to March 31, 1988

NOTE 1: SUMMARY OF ACCOUNTING POLICIES

The fund accountability statement of the project was prepared on the basis of cash receipts and disbursements in which certain revenue and related assets are recognized when received rather than when earned and certain expenditures are recognized when paid rather than when the obligation is incurred.

Accounting Period

The project began on January 1, 1985. Income and disbursements included in this statement cover the period from that date to March 31, 1988.

NOTE 2: GRANT AGREEMENT

On January 1, 1985, the Water for the People Association (the Association) signed grant agreement No. 520-0335 with the United States Agency for International Development in Guatemala (USAID/Guatemala) for the amount of US\$1,000,000. The purpose of this agreement was to fund the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No 520-0335. The project purpose was to improve environmental sanitation in approximately 62 rural communities in Guatemala.

NOTE 3: IMPLEMENTING UNIT

The project is managed by the Water for the People Association (the Association), a nonprofit institution whose administrative offices are located in the department of Quetzaltenango, 210 kilometers from Guatemala city.

NOTE 4: MONETARY UNIT

The fund accountability statement of the project is expressed in Quetzales (Q), the monetary unit of Guatemala. Foreign currency transactions must be realized through the banking system in which three different exchange rates have been established: The official market rate (Q1:US\$1) to pay the public debt and those private liabilities registered prior to June 6, 1986; the regulated market rate to pay for imports and liquidate exports, and the banking market rate for those transactions not included in the above mentioned markets. As of March 31, 1988, the regulated market rate was Q2.50:US\$1 and the banking market rate was Q2.55:US\$1. On June 23, 1988, the exchange rate applied in the regulated and banking markets was unified at Q2.70:US\$1.



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RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335

INTERNAL CONTROL STRUCTURE

AUDITOR'S OPINION

We have performed a financial audit of the fund accountability statement of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, managed by the Water for the People Association, for the period from January 1, 1985 to March 31, 1988 and have issued our report thereon dated February 3, 1989, in which we disclaimed our opinion due to the lack of financial information on the project and inadequate accounting records.

We conducted our audit in accordance with generally accepted auditing standards and the U. S. Comptroller General's "Government Auditing Standards" (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement.

In planning and performing our audit of the fund accountability statement of the Rural Potable Water and Sanitation II Project, managed by the Water for the People Association for the period from January 1, 1985 to March 31, 1988, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statement and not to provide assurance on the internal control structure.

The management of the Water for the People Association is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles or another comprehensive basis of accounting. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified and evaluated the significant accounting controls in the following areas:

- Procurement
- Inventories and fixed assets control
- Human and technological resources
- Internal accounting information systems

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

We noted certain matters involving the internal control structure and its operation, as described in the accompanying findings Nos. 1 to 6, that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

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

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We believe that the conditions described in the accompanying findings Nos. 1 to 6 and the findings Nos. 1 and 3 in the report on compliance with agreement terms, and applicable laws and regulations are material weaknesses.

This report is intended solely for the use of the Water for the People Association and USAID/Guatemala. 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.

Klyweld Pest Marwick Goedeke

February 3, 1989

RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335

INTERNAL CONTROL STRUCTURE

Findings

1. The Accounting System did not Provide Separate Accountability for Project Funds

Condition:

The Water for the People Association (the Association) does not have accounting records which provide separate accountability for project funds, both grant and counterpart.

Criteria:

The agreement requires full accountability for project funds.

Cause:

The Association's accounting system was not designed in a manner to provide separate accountability by source of funds, since the Association did not have subsidiary records for income and expenditures which identified the source of funds.

Effect:

There was a loss of accountability over USAID/Guatemala funds since income and expenditures for the project cannot be identified within the Association's overall financial records. Further, since we are unable to identify the transactions relating to the project, we must question the entire amount of claimed expenditures. (Also see finding No. 2 of this section).

Recommendation:

The Water for the People Association should:

- a) Implement the use of general ledger and subsidiary records reflecting USAID/Guatemala funds received and the expenses incurred against such funds, from the date of project inception. Appropriate controls should be implemented to maintain these records in a current and accurate condition, and these records should be the basis for financial reporting to USAID/Guatemala.

- b) Assign qualified personnel to its accounting department and supervise their work with a view towards meeting USAID/Guatemala's requirements for control over and accountability of A.I.D. money and ensuring timely and accurate financial reporting to USAID/Guatemala.

2. Financial Information Sent to USAID/Guatemala was not Based on Accounting Records

Condition:

- a) The financial information sent to USAID/Guatemala by the Association was based on its reimbursement requests to USAID/Guatemala and not on information in its accounting records.
- b) There was no way to trace from the Association's reimbursement requests to USAID/Guatemala back to the original supporting documentation.

Criteria:

As a normal internal control to assure the accuracy of financial reports, the reports should be based on the official accounting records of the organization. Also, the standard provisions which were incorporated into the agreement require that claimed costs be adequately documented.

Cause:

The Association's accounting system did not segregate the project's transactions. Also, no files were maintained identifying the source documentation supporting reimbursement requests and there was no other way to identify such documentation. (See finding No. 1 of this section).

Effect:

The financial information being submitted on the project was of uncertain reliability and the entire amount of the expenditures claimed for the project is questionable because it is not supported with documentation.

Recommendation:

The Water for the People Association should:

- a) Submit financial reports for the project which are based on its official accounting records, and
- b) Maintain files with the supporting documentation for the costs claimed to USAID/Guatemala.

3. Project Funds Were Commingled with the Association's own Funds

Condition:

Some of the funds received from USAID/Guatemala were deposited in a bank account established for the project, but later these funds were transferred to the Association's general bank account. Other funds received from USAID/Guatemala were deposited directly into the Association's general account. As an example of this latter situation, we can mention check Nos. 47138 and 47137 on Bank of America issued by USAID/Guatemala for Q 333,541.08 and Q 190,611.95, respectively. Additionally, the Association manages another USAID/Guatemala project, USAID/Guatemala Project No. 520-0298, whose funds were commingled into the bank account established for this project and the Association's general account.

Criteria:

The agreement requires that the funds provided by USAID/Guatemala for this project should be kept in a separate bank account.

Cause:

There was a breakdown of the internal controls. The funds were not managed as originally envisioned.

Effect:

The Association did not comply with the agreement and there was a loss of control over the use of project funds. In this regard, we noted that as of March 31, 1988, the specific bank account established for the project had Q210,814 in funds while the fund accountability statement as of that same date shows that the balance should have been only Q2,314.

Recommendation:

USAID/Guatemala should require the Water for the People Association (the Association) to:

- a) Ensure that USAID/Guatemala funds are deposited in their respective separate bank accounts when received and that withdrawals from these accounts are only made to pay the specific expenses of the specific USAID/Guatemala projects. Considering the Association's lack of subsidiary records to provide separate accountability for USAID/Guatemala project funds, we consider that the Association should pay the expenses of each USAID/Guatemala project by drawing checks against the respective project's specific bank account; and
- b) Reconcile the Q208,500 difference indicated between the Association's fund accountability statement as of March 31, 1988 and

the actual cash balance of the project's specific bank account at that date. If the difference cannot be reconciled, then consideration should be given to applying the indicated overage toward repaying questioned costs.

4. There Was no Accountability and Control over Project Inventory

Condition:

Project inventories were commingled with the inventories purchased with the Association's own funds and there was no way to tell how much belonged to USAID/Guatemala versus the institution since purchasing records did not identify whether the materials were being purchased by the institution for its own account or for the project, and there were no records kept at the warehouse identifying project inventories. Also, no warehousekeeper had been assigned to physically control the inventories and record receipts and issues of materials on kardex cards.

Criteria:

The agreement requires full accountability for project funds and this requirement extends to the accountability for project inventories. The full range of internal controls over inventory is necessary to ensure that the recorded accountability is correct and to guard against misappropriation of assets.

Cause:

No separate accountability was maintained for the project (see finding No. 1 of this section) and no internal controls had been implemented in the area of inventories.

Effect:

The project inventories could not be determined. Unauthorized removals could occur without being detected.

Recommendation:

The Water for the People Association should:

- a) Assign qualified personnel to the Association's warehouse and implement the use of subsidiary records (kardex cards), and implement receipt and issue forms to record and control the movement of warehouse stock. Separate accountability should be maintained for project inventories.

- b) **Perform selective physical inventories periodically and a complete inventory at least once a year.**

5. **There Was Inadequate Control over Fixed Assets**

Condition:

The Association's fixed assets subsidiary records identify the assets procured with USAID/Guatemala funds, but the Association manages two projects with USAID/Guatemala, and the records do not indicate for which project the purchases made belong. In addition, those records do not make reference to the documentation that supports each purchase.

Criteria:

All fixed assets should be assigned an identifying number and subsidiary records should be maintained indicating the source of funds used in the purchase, the asset's location, its code number and reference to the check number or other documentation that supports the purchase.

Cause:

The Association has not considered it necessary to implement this control.

Effect:

It is not possible to establish the fixed assets acquired by each USAID/Guatemala project.

Recommendation:

The Water for the People Association should implement subsidiary records for fixed assets, segregated by project. Each fixed asset should be assigned an identifying number and the subsidiary records should include this number, the asset's location, the source of funds used in the purchase and reference to the documentation that originated the purchase.

6. **The Valuation of Project Inventories was Improper**

Condition:

The valuation of project inventories was improper because the unit price used in the calculation for each line item was based on a straight average of the price paid for various purchases of line items rather than a weighted average.

The following example illustrates the difference in inventory valuation using the two methods:

Basic Information:	<u>Units Purchased</u>	<u>Unit Price</u>	<u>Total Value</u>
	200	\$ 5	\$1000
	<u>120</u>	<u>\$ 6</u>	<u>\$ 720</u>
	320		\$1720

Calculation of Inventory Value

Method used:

<u>total of unit prices</u>	X	total Units	=	Inventory Valuation	Difference from actual
# of unit prices					

$\frac{\$ 11}{2} = \5.50	X	320	=	\$1760	\$40
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Weighted average method:

<u>total amount paid for units</u>	X	total Units	=	Inventory valuation
Total of units				

$\frac{\$ 1720}{320} = \$ 5.375$	X	320	=	\$1720
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Criteria:

The agreement requires accountability of project funds in accordance with generally accepted accounting principles which include proper valuation of inventories. There are three inventory valuation methods more commonly used: First In, First Out (FIFO); Last In, First Out (LIFO), and weighted average.

Cause:

Internal controls had not been implemented in the area of inventories. In addition, the Association did not have qualified accounting personnel.

Effect:

The inventories were not properly valued.

Recommendation:

The Water for the People Association should adopt a valuation method that accurately reports the value of project inventories.



Peat Marwick

Certified Public Accountants

P. O. Box 1020
Guatemala, C. A.

**RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

**COMPLIANCE WITH AGREEMENT TERMS AND APPLICABLE LAWS AND
REGULATIONS**

AUDITOR'S OPINION

We have audited the fund accountability statement of the Rural Potable Water and Sanitation II Project, USAID/Guatemala Project No. 520-0335, managed by the Water for the People Association (the Association), for the period from January 1, 1985 to March 31, 1988 and we have issued our report thereon dated February 3, 1989 in which we disclaimed our opinion due to lack of financial information on the project and inadequate records.

We conducted our audit in accordance with generally accepted auditing standards and the U. S. Comptroller General's "Government Auditing Standards" (1988 Revision). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement.

Compliance with agreement terms, and laws and regulations applicable to the Rural Potable Water and Sanitation II Project is the responsibility of the Water for the People Association's management. As part of obtaining reasonable assurance about whether the fund accountability statement is free of material misstatement, we performed tests of the Association's compliance with certain provisions of the agreement and applicable laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

The lack of financial information and the inadequate records as detailed by findings Nos. 1 through 6 of our report on internal accounting controls and the accompanying findings Nos. 1 to 3 prevent us from expressing, and we do not express, positive assurance on items tested for compliance with agreement terms and applicable laws and regulations or negative assurance on items not tested.

This report is intended solely for the use of the Water for the People Association and the U. S. Agency for International Development. 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.

Klynweld Pest Marwick Goedeke

February 3, 1989

RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335

COMPLIANCE WITH AGREEMENT TERMS AND APPLICABLE LAWS AND
REGULATIONS

Findings

1. Fixed Assets Were Acquired Without USAID/Guatemala Authorization

Condition:

The Water for the People Association bought two Jeep-type vehicles from the firm Cofiño Stahl with check No. 3 from account 02-23828-3 (USAID/Guatemala) and check No. 201 from account 01-7966-5 for the amount of Q 30,000 and Q 77,214, respectively. These costs could be identified as having been charged to the project. However, we could find no evidence that USAID/Guatemala authorized this purchase as required by the agreement.

Criteria:

According to the agreement, vehicle acquisitions should be supported by an implementation letter from USAID/Guatemala. Also, the agreement required that USAID/Guatemala approval be obtained for purchases greater than US \$5,000.

Cause:

The Association did not follow the established procedures with respect to the authorization for these acquisitions.

Effect:

The purchases were not in accordance with the agreement requirements. Therefore, we consider the costs to be questionable and in suspense.

Recommendation:

The Water for the People Association should:

- a) Provide documentation showing that USAID/Guatemala approved the purchase of the Jeep-type vehicles mentioned in this finding or reimburse USAID/Guatemala for the purchase price of these vehicles which was charged to this project.
- b) Obtain approval from USAID/Guatemala for all purchases greater than US\$5,000, and, in the case of vehicle purchases, obtain documentation of this authorization and approval in the form of a project implementation letter as required by the agreement.

2. The Association Had Not Submitted Income Tax Returns

Condition:

The Association had not submitted its income tax returns for the period 1987 and 1988, as required by Guatemala's Income Tax Law.

Criteria:

Under the Income Tax Law (Decree 59-87 and its amendments), Article 6 (c), the Association is considered to be exempt from the payment of tax. However, under Article 60, it is obligated to file an income tax return for information purposes only.

Cause:

The Association was not aware of the requirement of this law.

Effect:

The Association may be liable, under Article 82 of the Income Tax Law, to a fine of not less than Q 200 or more than Q 5,000.

Recommendation:

The Water for the People Association should prepare income tax returns for 1987 and 1988 and submit them to Guatemala's Directorate General of Internal Revenue as required by Guatemala's Income Tax law.

3. Purchases Did Not Meet the Bidding Procedure Required by the Agreement

Condition:

During our review of the checks issued from the bank account where some of the project's funds were deposited, we detected that some purchases did not meet certain procurement procedures required by the agreement, as detailed in Annex 1. Due to lack of subsidiary records, we could not be identify which USAID/Guatemala project these disbursements should have been charged to or whether the funds were used for other Association purposes.

Criteria:

According to the agreement, all purchases greater than US\$ 1,000 should be supported at least by three quotations.

Cause:

The Association disregarded the terms of the agreement.

Effect:

The Association did not comply with the terms of the agreement and it was not possible to determine whether the funds were actually used for project purposes only.

Recommendation:

The Water for the People Association should implement procurement procedures that ensure that all the purchases for amounts greater than US\$1,000 are supported by at least three quotations, with evidence in writing that they were approved by responsible officers.

**RURAL POTABLE WATER AND SANITATION II PROJECT
WITH THE WATER FOR THE PEOPLE ASSOCIATION
USAID/GUATEMALA PROJECT No. 520-0335**

LIST OF REPORT RECOMMENDATIONS

INTERNAL CONTROL STRUCTURE

Recommendation No. 1

The Water for the People Association should:

- a) Implement the use of general ledger and subsidiary records reflecting USAID/Guatemala funds received and the expenses incurred against such funds, from the date of project inception. Appropriate controls should be implemented to maintain these records in a current and accurate condition, and these records should be the basis for financial reporting to USAID/Guatemala.
- b) Assign qualified personnel to its accounting department and supervise their work with a view towards meeting USAID/Guatemala's requirements for control over and accountability of A.I.D. money and ensuring timely and accurate financial reporting to USAID/Guatemala.

Recommendation No. 2

The Water for the People Association should:

- a) Submit financial reports for the project which are based on its official accounting records, and
- b) Maintain files with the supporting documentation for the costs claimed to USAID/Guatemala.

Recommendation No. 3

USAID/Guatemala should require the Water for the People Association (the Association) to:

- a) Ensure that USAID/Guatemala funds are deposited in their respective separate bank accounts when received and that withdrawals from these accounts are only made to pay the specific expenses of the specific USAID/Guatemala projects. Considering the Association's lack of subsidiary records to provide separate accountability for USAID/Guatemala project funds, we consider that the Association should pay the expenses of each USAID/Guatemala project by drawing checks against the respective project's specific bank account; and

- b) Reconcile the Q208,500 difference indicated between the Association's fund accountability statement as of March 31, 1988 and the actual cash balance of the project's specific bank account at that date. If the difference cannot be reconciled, then consideration should be given to applying the indicated overage toward repaying questioned costs.

Recommendation No. 4

The Water for the People Association should:

- a) Assign qualified personnel to the Association's warehouse and implement the use of subsidiary records (kardex cards), and receipt and issue forms to record and control the movement of warehouse stock. Separate accountability should be maintained for project inventories.
- b) Perform selective physical inventories periodically and a complete inventory at least once a year.

Recommendation No. 5

The Water for the People Association should implement subsidiary records for fixed assets, segregated by project. Each fixed asset should be assigned an identifying number and the subsidiary records should include this number, the asset's location, the source of funds used in the purchase and reference to the documentation that originated the purchase.

Recommendation No. 6:

The Water for the People Association should adopt a valuation method that accurately reports the value of project inventories.

COMPLIANCE WITH AGREEMENT TERMS AND APPLICABLE LAWS AND REGULATIONS

Recommendation No. 1

The Water for the People Association should:

- a) Provide documentation showing that USAID/Guatemala approved the purchase of the Jeep-type vehicles mentioned in this finding or reimburse USAID/Guatemala for the purchase price of these vehicles which was charged to this project.
- b) Obtain approval from USAID/Guatemala for all purchases greater than US\$5,000, and, in the case of vehicle purchases, obtain documentation of this authorization and approval in the form of a project implementation letter as required by the agreement.

Recommendation No. 2

The Water for the People Association should prepare income tax returns for 1987 and 1988 and submit them to Guatemala's Directorate General of Internal Revenue as required by Guatemala's Income Tax law.

Recommendation No. 3

The Water for the People Association should implement procurement procedures that ensure that all the purchases for amounts greater than US\$1,000 are supported by at least three quotations, with evidence in writing that they were approved by responsible officers:

**PURCHASES WHICH DID NOT MEET THE BIDDING
PROCEDURE REQUIRED BY THE AGREEMENT**

CHECK No.	DATE	SUPPLIER	AMOUNT	PURPOSE
20514	9/17/85	POLYMER, S. A.	Q 7,253.71	Purchase of materials
20515	9/17/85	POLYMER, S. A.	4,805.05	Purchase of materials
20518	11/15/85	FERRETERIA LA GARRUCHA	10,328.95	Purchase of materials
20536	12/17/85	TRANSPORTES OVALLE	5,110.00	Transport of materials
20570	2/6/86	FERRETERIA LA GARRUCHA	19,175.70	Purchase of materials
20572	2/6/86	TUBOVINIL	4,158.61	Purchase of materials
20578	2/13/86	POLYMER, S. A.	3,141.52	Purchase of materials
20579	2/13/86	FERRETERIA LA GARRUCHA	13,861.89	Purchase of materials
20585	2/20/86	TUBOVINIL	20,086.36	Purchase of materials
20597	2/27/86	TUBOVINIL	88,776.07	Purchase of materials
3	6/10/86	COFIÑO STHAL	30,000.00	Purchase of 2 vehicles
24	8/22/86	EQOS, S. A.	3,552.40	Purchase of IBM typing machine
83	12/18/87	TUBOVINIL	26,211.38	Purchase of materials
96	2/3/88	FERRETERIA LA PREDILECTA	3,105.68	Purchase of cement
99	2/24/88	POLYMER, S. A.	<u>18,223.88</u>	Purchase of materials
			Q 257,791.20	
			=====	

APPENDIX I

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