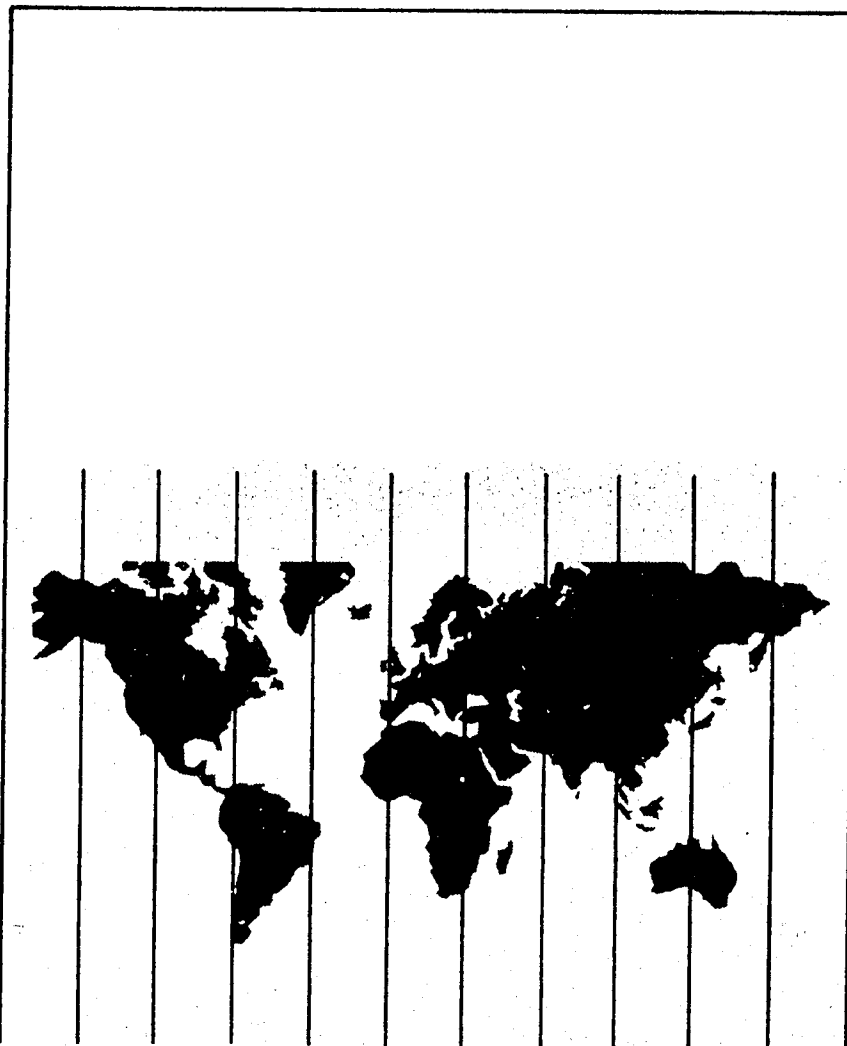


UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit

TEGUCIGALPA

10/15/85

PD-ACD-128

**AUDIT OF USAID/PERU'S
RURAL WATER SYSTEMS AND
ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH
SEPTEMBER 25, 1980 TO JUNE 30, 1989**

**Audit Report No. 1-527-91-45-N
August 19, 1991**

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

AGENCY FOR INTERNATIONAL DEVELOPMENT

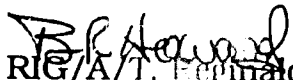
OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

TELEPHONES:
32-9987 - 32-3120
FAX No. (504) 31-4467

August 19, 1991

MEMORANDUM

TO: D/USAID/Peru. Craig Buck

FROM: 
RIG/A/T, Reginald Howard

SUBJECT: Audit of USAID/Peru's Rural Water Systems and Environmental Sanitation Project, Managed by the Ministry of Health, September 25, 1980 to June 30, 1989

This report presents the results of a non-Federal financial audit of the Rural Water Systems and Environmental Sanitation Project, USAID/Peru Project No. 527-0221, managed by the Government of Peru's Ministry of Health (Ministry), for the period September 25, 1980 to June 30, 1989. The accounting firm of Moores & Rowland International prepared the report, which is dated June 25, 1991.

The purpose of the Project was to provide water systems, latrines, and health education to 1,200 communities having a population of less than 500 inhabitants and located in Peru's mountains and high jungle regions. The audit coverage included \$7,448,383 provided by A.I.D. to the Ministry to implement the Project.

The objectives of the audit were to determine whether: (1) the Ministry's fund accountability statement for the period audited presents fairly Project receipts and disbursements, (2) the internal control structure of the Ministry was adequate to manage the Project's funds, and (3) the Ministry complied with agreement terms and applicable laws and regulations. The scope of the audit included an examination of the Ministry's activities and transactions to the extent considered necessary to issue a report thereon for the period under audit.

The auditors found that the Ministry: (1) had not maintained an adequate and comprehensive accounting system capable of generating a reliable fund accountability statement, (2) was not able to provide supporting documentation for Project disbursements for the period from 1982 to 1984, and (3) could not provide sufficient supporting information relating to construction costs incurred under the project. Because of these scope limitations the auditors were unable to express an opinion on the fund accountability statement. The auditors

identified questionable costs of \$1,545,686 (\$123,600 questioned and \$1,422,086 unsupported).

The auditors found two material weaknesses in the Ministry's internal control structure. These weaknesses concerned the Ministry's lack of an adequate and comprehensive accounting system and insufficient warehouse procedures to properly account for inventories. Also, the auditors reported non-compliance with agreement terms and applicable laws and regulations concerning the lack of counterpart contributions, inadequate accounting books and records, and inadequate progress reports.

This report was discussed with the Executive Director of the Ministry of Health's division of Basic Rural Sanitation, who expressed general agreement with its content.

We are not including recommendations relating to the internal control and compliance deficiencies identified in the auditors' report because the Project has been completed. However, if the Mission uses the Ministry of Health to manage future projects, we suggest that they ensure that the Ministry has established adequate policies and procedures to prevent reoccurrence of the reported deficiencies.

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

Recommendation No. 1

We recommend that USAID/Peru negotiate a settlement with the Government of Bolivia's Ministry of Health resolving questionable costs totaling \$1,545,686 (\$123,600 questioned and \$1,422,086 unsupported) as described in the Moores & Rowland International audit report dated June 25, 1991.

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

**AUDIT OF THE
RURAL WATER SYSTEMS AND ENVIRONMENTAL
SANITATION PROJECT MANAGED BY
THE MINISTRY OF HEALTH
USAID/PERU PROJECT NO.527-0221
PERIOD SEPTEMBER 25, 1980 TO JUNE 30, 1989**

**AUDIT OF THE
RURAL WATER SYSTEMS AND ENVIRONMENTAL
SANITATION PROJECT MANAGED BY
THE MINISTRY OF HEALTH
USAID/PERU PROJECT NO.527-0221
PERIOD SEPTEMBER 25, 1980 TO JUNE 30, 1989**

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Spear, Safer,
Harmon & Co.

**RAMIREZ
ENRIQUEZ Y
ASOCIADOS**
Contadores Públicos 

Junio 25, 1991

Mr. Reginal Howard
Regional Inspector General for Audit
U.S. Agency for International Development
Tegucigalpa Honduras, C.A.

Dear Mr. Howard:

This report presents the results of the Audit Report of the Rural Water System and Environmental Sanitation Project, USAID/PERU No. 527-0221 for the period from September 25, 1980 to June 30, 1989.

BACKGROUND

The Project is included within the scope of the National Plan for Rural Water Systems approved by Law No. 13997 dated February 6, 1962, by which the Ministry of Health takes charge of the execution of the plan on a nationwide basis through its specialized technical entities, the plan has the purpose of providing water systems to the rural areas of the country, that represents 47.85% of the population of Peru, according to estimates of the Ministry of Health. Because of the high investment required to implement the National Plan for Rural Water Systems and the lack of sufficient resources in the Public Treasury of Peru, Peru asked for the cooperation and assistance of International Financial Agencies.

On September 25, 1980, the Government of the United States of America, through the Agency for International Development Mission to Peru USAID/PERU, and the Government of Peru represented by the Minister of Economy and Finance, signed the Loan and Grant Agreement No. 527-0221 "Rural Water Systems and Environmental Sanitation Project", which was previously authorized by USAID/PERU on September 22, 1980.

1. Purpose and Description of the Project

The purpose of the Project was to provide water systems, latrines and health education in 420 communities with a population of less than 500 inhabitants in its health regions in the mountains and the high jungle. Subsequent amendments to the agreement and the Implementation Letter No. 34 dated May 9, 1986 established changes referring to the objectives, the scope of application, the amount to be financed and the completion date of the Project. The matters have been determined as follows:

- * **Goals of the Project** - Originally the number of water systems were 420. The number of water systems was increased to 1200.
- * **Scope of application** - Initially it was limited to six regional offices but it was subsequently increased to 18.
- * **Financing** - The original amount of US\$ 8,100,000 was increased to US\$ 16,200,000, including the following sources:

Loans	USAID/PERU	US\$10,000,000
Grants	USAID/PERU	1,000,000
Peruvian Government		
Counterpart		<u>5,200,000</u>
Total		<u>16,200,000</u>

2. **Specific Objectives and Components of the Project**

The specific objective was to install gravity-fed systems with connections and the exploration of other alternatives to provide the communities adequate water systems encouraging the construction of private latrines.

The components of the Project are:

- * **Rural water systems** - The types of water systems to be installed are as follows: gravity-fed systems with household connections; gravity-fed systems terminating at public taps or hand-dug wells with hand pumps.
- * **Latrines** - The construction of latrines will be promoted in the places where these systems are installed.
- * **Community participation** - The participation of communities selected will be by means of cash contributions, unskilled labor and locally available materials.
- * **Health education** - To enhance proper use and maintenance of water systems and latrines, continuing health education will be provided as well as additional material through the Primary Health Project (527-U-072).
- * **Special studies** -In order to improve the implementation of the system the following studies will be provided:
 - Latrine studies.
 - Use of the water to determine the behavior patterns in its use.

- Effectiveness of the system, comparing the impact of various forms of services in the prevalence of diarrhea.
- Appropriate technology for systems of simplified treatment.
- * **Training** - Training will be provided for sanitation technicians and supervisors on the regional level and for community administrators and maintenance personnel at the community level.
- * **Technical assistance** - For the different regions in the initial phase of the Project in terms of organization, planning, information and control systems and other related activities. Also, for the design and testing of different maintenance procedures and to strengthen aspects of the educational program and community organization.

3. **Entities in Charge of the Project Administration**

The Ministry of Health, responsible for the direction and administration of the Project, assigned the Sanitary Engineering Division (DIS) as the technical entity in charge of the Project's implementation. Because of changes in the organization of the Ministry of Health other technical entities took charge of the responsibility of administering the Project. However, the technical staff were always transferred to the new responsible entity. This assured the continuity in its technical administration. In the general administration and accounting aspects, except for warehousing, the same policy of continuity was not applied and, therefore, these functions were performed by the personnel of the new technical entity.

In summary, the administration of the Project after DIS was held by the following technical entities of the Ministry of Health:

- * Division of Rural Sanitation-DISAR (for the year 1981).
- * General Division of Environment-DIGEMA (from 1982 to 1985).
- * General Division of Construction (for the year 1986).
- * Division of Basic Rural Sanitation-DISABAR (from 1987 to 1989).

AUDIT OBJECTIVES AND SCOPE

We conducted our audit in accordance with generally accepted auditing standards and the United States 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 financial statements are free of material misstatement.

The audit did not include examination of transactions made directly by USAID/Peru and the Government of Peru.

According to the terms of our proposal of professional services and the work requested by USAID/RIG/A/T the objectives, scope, methodology and limitations were the following:

1. Examine the Fund Accountability Statement of the Project for the period from September 25, 1980 to June 30, 1989, to determine if it presents fairly, in all material respects, the financial activities of the implementing institutions and if costs incurred and reimbursed by USAID/PERU during the period are allowable, allocable and reasonable in accordance with Agreement terms, and applicable laws and regulations.

During our examination we found that the entities administering the Project did not maintain, in accordance with generally accepted accounting principles, accounting books and records. The Division of Basic Rural Sanitation - DISABAR prepared a Fund Accountability Statement instead of financial statements for the period under examination. The Fund Accountability Statement was prepared on a cash basis method which is a comprehensive basis of accounting other than generally accepted accounting principles.

The supporting documentation of the Project costs is not adequately filed and could not be located in full. For that reason, disbursements between 1982 and 1984 of US\$1,321, 049 corresponding to loan advances and US\$101,037 to grant advances made by USAID/PERU are considered questionable costs.

Our examination included a selective review of the supporting documentation to establish the fairness of the loans and grants advances as well as the supporting costs of the Project, including the Fund Accountability Statement for the period between September 25, 1980 and June 30, 1989.

2. Evaluate and review the internal control structure with the purpose of determining to what extent the implementing entity of the Project has followed policies and procedures for the proper management of the Project's funds.

We performed an evaluation of the internal control structure of the Division of Basic Rural Sanitation-DISABAR, which, as of date of our examination was the entity in charge of the Project's administration. In 1987, DISABAR became responsible for the Project's administration, acquiring the technical staff which has been previously supervising the Project (see

item 3 on page 5). Our evaluation was performed using flow charts to review the flow of the operations, as well as the application of internal control questionnaires; according to the progress of our examination we performed additional tests of the controls which we considered necessary to provide more evidence about the effectiveness of the design and operation of relevant internal control structure policies and procedures.

3. Verify the compliance of the Agreement terms, laws and regulations applicable to the Project and their effect on the Fund Accountability Statement together with the achievement of the objectives stated therein.

The water systems and latrines installed were evaluated, on a selective test basis, by a civil engineer.

The "fronts" (administrative units for various localities where the systems were installed) visited were the following:

- * In the Region of Arequipa-Yasso Arecocha, Togra, Tipan Paracolca, Toran, Acoy, La Pampa, La Barranca and Cosos Bilbao - (eight locations).
 - * In the Region of Puno - Camiraya Molino, Machacmarca, Santa Rosa de Pichicho, Sacacatani, Challpampa, Pueblo Libre y Cruz Pata - (seven locations).
 - * In the Region of Cajamarca - Manzanamayo, Quinuapata, Cernillos, Ventanilla de Otuzco, Rinconada, La Banda - (six locations).
 - * In the Region of Piura - Ullma, Manay Grande, Tunal, La Laguna y Papayo - (five locations).
 - * In the Region of Ica - Molletambo - (one location).
4. In connection with the objectives described above and within the scope of our audit we reviewed the following audit reports issued during the life of the Project: (1) Independent Auditor's reports on the administrative and financial review of the Project for the period from January 1, 1984 to May 31, 1988, as well as (2) the reports of the administrative audit issued by the General Comptroller of the Republic of Peru and the Ministry of Health Inspector.

The purpose of this review was to determine if appropriate corrective measures recommended in the audit reports were put into effect.

RESULTS OF AUDIT

According to the objectives of the examination and as a result of the application of our audit tests, we have obtained the following results:

1. Fund Accountability Statement.

We have examined the Fund Accountability Statement which can be summarized as follows:

<u>In U.S. Dollars</u>			
<u>Concept</u>	<u>Loans</u>	<u>Grants</u>	<u>Total</u>
Budget	10,000,000	1,000,000	11,000,000
Receipts	6,755,082	693,301	7,448,383
Disburse- ments	-6,755,082	-693,301	-7,448,383

We do not express an opinion on the Fund Accountability Statement due to the following scope limitations encountered in the process of our examination:

- * Lack of accounting books and records to support and summarize the operations of the Project.
- * There is no supporting documentation about loan and grant disbursements of US\$ 1,321,049 and US\$ 101,037 respectively, corresponding to the years 1982 and 1984.
- * No information was presented to support the construction costs due to weaknesses and limitations in the accounting internal control system and in the stores and warehouse.

We have also identified questionable costs of US\$ 123,600 corresponding to the purchase of 24 water pumps which were received by DISABAR in December of 1990, that is 18 months after the Project Assistance Completion Date (PACD).

2. Internal control structure

We evaluated the internal control structure related with the financial and administrative operations of DISABAR.

The more significant aspects identified in the study and evaluation of the internal control structure are as follows:

- * Lack of supervision provided by responsible officials of DISABAR with respect to the follow-up of purchases made with the Project funds. As a consequence an amount of US\$ 123,600 was disbursed in 1987 for the purchase of water

pumps, which were not received until the end of 1990. The Project was terminated on June 30, 1989 in accordance with the Implementation Letter No. 34.

- * There are no records or appropriate information related to the transfer of supporting documentation of investment and expenses to the new administrative entities, nor any measure taken for its appropriate custody and conservation of the records and documentation. This weakness has prevented DISABAR from providing us with all the supporting information for the disbursement of US\$ 1,422,086 made during the years 1982 to 1984.
- * There was no accounting system which could enable DISABAR and the other implementing entities to prepare adequate financial information. Additionally, no audit procedure was performed on a periodic basis with the purpose of identifying existing problems and implementing the corrective measures.
- * There were inadequate and insufficient procedures in the warehouse to properly account for all the inventories. The following weaknesses regarding the warehouse procedures were found:
 - No perpetual inventory system recorded the movement of inventories, thus, making it impossible to determine the number of units purchased, delivered and their proper cost.
 - As a consequence of the preceding weakness no physical count was taken to reconcile and update the inventory balances.

These limitations, together with the lack of a proper accounting system and records, did not allow us to verify the material and other related construction costs used in each system built.

3. Compliance with the Agreement terms and applicable laws and regulations

We have reviewed the clauses of the Agreement and Pertinent Laws and Regulations to determine if there was a lack of compliance. Additionally, laws and regulations related with agreement clauses have been evaluated to determine in what extent could have affected the Fund Accountability Statement.

Our tests disclosed the following lack of compliance with some clauses of the Agreement:

- * The administration of the Project has not kept accounting records and books. The financial statements have not been prepared or audited regularly. Additionally, the supporting documentation is not kept in order, classified, filed and accessible for review.
- * There are goods purchased with project funds which were not used during the execution of the Project. Our tests disclosed a payment in 1987 of US\$ 123,600 for the purchase of 24 water pumps which were received by DISABAR in December of 1990, that is, 18 months after the termination of the Project.

TECHNICAL ENGINEERING EVALUATION

According to the terms of our service agreement with RIG/IR/USAID/Honduras, we have performed a technical and operational evaluation of the water systems and latrines with the help of a highly experienced civil engineer. The specific objectives were the following:

- * Determine if the water systems and latrines follow specified design techniques.
- * Determine if labor and material components were used in correct proportion in the construction of the water systems and latrines built.

In order to comply with the aforementioned objectives, we performed selective visits to different "fronts" (administrative units for various localities where the systems were installed) of the Project located around the Republic of Peru.

In most of the places visited we did not receive support for the planned inspection but such limitation did not restrict the compliance of our work.

Our evaluation has allowed us to assess in general terms that the water systems and latrines inspected comply with regulations, technical specifications and established standards. However, (1) there is no information on the amount and cost of materials and labor used in the constructions and (2) the technical documentation does not include all the information that would allow us to verify in each specific case that the construction process and supervision was accomplished.

In an accompanying report we set forth further comments on the technical characteristics of the water systems and latrines built, the objectives and scope of our examination and their results.

MANAGEMENT COMMENTS:

This report has been discussed with the Executive Director of the division of Basic Rural Sanitation-DISABAR, who is in general agreement with its contents. Specific comments are reproduced in Annex 1.

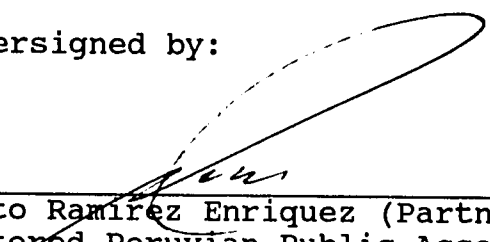
January 30, 1991

Spear, Safer, Harmon & Co.

Spear, Safer, Harmon & Co.

Miami, Florida USA

Countersigned by:


Alberto Ramirez Enriquez (Partner)
Registered Peruvian Public Accountant
Register No. 2281

Ramirez Enriquez y Asociados



Spear, Safer,
Harmon & Co.

**RAMIREZ
ENRIQUEZ Y
ASOCIADOS**
Contadores Públicos 

**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT NO.527-0221.
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989**

**FUND ACCOUNTABILITY STATEMENT
INDEPENDENT AUDITOR'S REPORT**

1. We were engaged to audit the accompanying Fund Accountability Statement of the **Rural Water Systems and Environmental Sanitation Project, USAID/PERU Project 527-0221** managed by the Ministry of Health of Peru, for the period from September 25, 1980 to June 30, 1989. This statement is the responsibility of the Ministry of Health and the Division of the Basic Rural Sanitation Direction-DISABAR, (a technical office of the Ministry of Health). Our responsibility is to express an opinion on the Fund Accountability Statement based on our audit.
2. Our examination was limited by the following situations:
 - a) The Project USAID/PERU 527-0221 as implemented by DISABAR does not maintain an adequate and comprehensive accounting system which can generate a reliable Fund Accountability Statement on a periodic basis.
 - b) We did not receive supporting documentation for the loan and grant disbursements of US\$ 1,321,049 and US\$ 101,037, respectively, from 1982 to 1984. However, such amounts are included in the Fund Accountability Statement and are classified as questionable costs and as such are reimbursable to USAID.
 - c) Insufficient information on construction costs does not allow us to form an opinion on its fairness. The internal control structure in the warehouse area is very limited and prevented the application of alternative audit procedures.
3. Because of the scope limitations described above we believe that our examination does not provide a reasonable basis for us to express and we do not express an opinion on the Fund Accountability Statement for the period from September 25, 1980 to June 30, 1989.
4. The attached Fund Accountability Statement includes questionable costs for an amount of US\$123,600 corresponding to the purchase of 24 water pumps received 18 months after the completion date of the Project, established on June 30, 1989.

5. This report is intended solely for the information and use of the Ministry of Health of Peru and the U.S. Agency for International Development. This restriction is not intended to limit the distribution of this report which upon acceptance of the Office of the Inspector General, is a matter of public record.

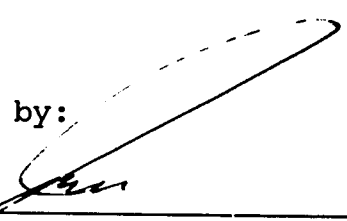
January 30, 1991

Spear, Safer, Harmon & Co.

Spear, Safer Harmon & Co.

Miami, Florida USA

Countersigned by:



Alberto Ramirez Enríquez (Partner)
Registered Peruvian Public Accountant
Register No. 2281

Ramirez Enríquez y Asociados

THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT No.527-0221

FUND ACCOUNTABILITY STATEMENT
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989
(Notes from 1 to 5)
(In U.S. Dollars)

Investment categories (Note 3)	B U D G E T			R E C E I P T S			D I S B U R S E M E N T S			Q U E S T I O N A B L E		C O S T Total disbursement
	Loan	Grant	Total	Loan	Grant	Total	Loan	Grant	Total	Questioned	Unsupported	
Construc- tions	7,300,000	--	7,300,000	4,677,129	--	4,677,129	4,677,129	--	4,677,129	--	(887,652)	3,789,477
Vehicles & equipment	1,910,200	--	1,910,200	1,596,830	--	1,596,830	1,596,830	--	1,596,830	(123,600)	(150,493)	1,322,737
Technical assistance	--	526,978	526,978	--	383,834	383,834	--	383,834	383,834	--	--	383,834
Training & education	--	290,000	290,000	--	217,738	217,738	--	217,738	217,738	--	(92,079)	125,659
Studies & evaluation	--	183,022	183,022	--	91,729	91,729	--	91,729	91,729	--	(8,957)	82,772
Support expenses	600,000	--	600,000	481,123	--	481,123	481,123	--	481,123	--	(282,905)	198,218
Others	189,800	--	189,800	--	--	--	--	--	--	--	--	--
	10,000,000	1,000,000	11,000,000	6,755,082	693,301	7,448,383	6,755,082	693,301	7,448,383	(123,600)	(1,422,086)	5,902,697

The accompanying notes are an integral part of this statement.

**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT No.527-0221**

**NOTES TO THE FUND ACCOUNTABILITY STATEMENT
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989**

1. DESCRIPTION OF THE PROJECT FINANCING AND OPERATIONS

The Ministry of Health is in charge of the National Plan of Rural Water Systems, approved by Law 13997 of February 6, 1962. It aims to provide water systems to rural areas. The Project was partially financed with funds of international organizations due to the lack of resources of the Public Treasury of Peru.

The Government of the United States of America represented by the Agency for International Development in Peru-USAID/PERU and the Government of Peru, represented by the Ministry of Economy and Finances, signed an agreement on September 25, 1980 to implement the Project 527-0221 of Rural Water Systems and Environmental Sanitation, in order to provide water systems, latrines and health education in 1200 communities with less than 500 inhabitants. The agreement was executed on September 25, 1980 and had an initial completion date of September 30, 1985, it was subsequently extended to June 30, 1989.

Project financing

The agreement signed between USAID and the Government of Peru established the following financing sources:

- a) **Loan** - USAID agreed to lend US\$ 10,000,000 to finance constructions, vehicles, equipment, support expenses and others.

The Government of Peru will pay the loan within 25 years term at interest rates of 2% and 3% annually, payable in 10 and 15 years respectively. Only 68% of the maximum amount of the loan was actually disbursed.

The payment of interest, according to clause 4.1 of the Agreement, was due in July, 1982. The first installment of principal, according to clause 4.2 of the Agreement, will start in January, 1992.

- b) **Grant** - It includes USAID funds to finance technical support, training, education, studies and evaluation of the Project. The maximum amount of the grant was US\$ 1,000,000. Only 69% of the grant was actually received.

- c) **Peruvian Government Counterpart** - The Government of Peru will provide the equivalent of US\$ 5,200,000 in local currency to finance construction, support expenses and other. Only 67% of the maximum amount was actually disbursed.

Project operations

The operations began on January 20, 1982 with the first disbursement made by USAID/PERU. The purpose of the Project was to provide 1200 water systems, latrines and health education to communities with less than 500 inhabitants. As of December 31, 1989, the Project was able to finance the construction of 1,041 water systems and 38,788 latrines.

At the beginning of the Project, the Division of Sanitary Engineering-DIS was the technical office in charge of its implementation, at a later date it was replaced by the Division of Rural Sanitation-DISAR, the General Division of Environment-DIGEMA and the General Division of Construction. Finally in 1987 the Division of Basic Rural Sanitation-DISABAR took charge of the Project's management.

2. ACCOUNTING PRACTICES

a) Accounting system

DISABAR is a Technical entity of the Ministry of Health, which before 1987 was part of the General Division of the Construction Division and the General Division of Environment, respectively and has been in charge of the Project Administration, except for the accounting control which was managed by the General Divisions. As of 1987, DISABAR took charge of the Project administration, as well as of other programs financed with sources other than those of USAID. As a consequence, DISABAR started to establish accounting systems based on government accounting standards. The accounting operations of DISABAR does not include the Project operations incurred between 1982 and 1986, whose direct responsibility was held by other entities of the Ministry of Health. During the years 1980 and 1981 no disbursement had been made for the project's implementation.

DISABAR and the previous administrative entities who were in charge of the project for a determined period of its life did not accumulate the relevant information and transfer it to the other, in such a way that it would be possible to design and implement an adequate and comprehensive accounting system for the project USAID/ PERU No. 527-0221.

b) The most significant accounting practices used to prepare the Fund Accountability Statement are as follows:

(1) The summary of receipts and disbursements supported by the statement of liquidation, submitted to USAID/PERU by DISABAR and the former entities responsible of the Project, were prepared using the cash method of accounting which is a comprehensive basis other than the generally accepted accounting basis.

(2) Loan and grant disbursements in local currency were translated to U.S. dollars, using the exchange rate to convert the amounts advanced by USAID/PERU to the entities. This rate was used until each advance was fully documented and liquidated through the statements of liquidation.

3. INVESTMENT CATEGORIES

a) Constructions - It includes equipment, materials and qualified labor for the installation of water systems and latrines in the locations selected in the Health Regions.

b) Vehicles and equipment - It includes the transportation equipment, construction, engineering, design, offices, promotion and laboratory to implement the Project offices in accordance with the objectives and goals of the Agreement.

This category includes the disbursement of US\$ 123,600 to Wiese Representations S.A. in 1987 to purchase 24 water pumps, of which only 18 were received by DISABAR in December, 1990.

c) Technical assistance - It includes the support to the regions in the first phase of the Project for the organization, planning, information, control and other activities as design and test of different procedures of maintenance and similar programs.

d) Training and education - for the staff of the Project.

e) Studies and evaluation - for the ultimate development of the Project.

f) Support expenses - Includes salaries, travel, and per diem, operation and maintenance of vehicles, establishment of offices and warehouse area.

4. NATIONAL COUNTERPART

The Peruvian Government provided funds as national counterpart in local currency (intis). These amounts were translated to U.S. Dollars for comparative purposes, using the average exchange rate at year end. These funds are summarized as follows:

In U.S. Dollars

<u>Investment Categories</u>	<u>Budgeted</u>	<u>Receipts</u>	<u>Disbursements</u>
Constructi ons	1,854,000	34,498	34,498
Vehicles & equipment	-	3,150	3,150
Support Expenses	2,817,000	3,206,532	3,206,532
Others	449,000	-	-
Sales tax	<u>80,000</u>	<u>221,664</u>	<u>221,664</u>
Total	<u>5,200,000</u>	<u>3,465,844</u>	<u>3,465,844</u>
Percentage	100%	67%	67%

Disbursements were initiated on January 1982, fifteen months after the agreement date. For this reason the goals were not fulfilled.

5. QUESTIONABLE COSTS

Those costs not allowable under the terms of the agreement are questioned costs, and those not fully supported by adequate documentation are unsupported costs.

- a) Questioned costs.- DISABAR disbursed between June 30 and September 11, 1987, US\$ 123,600 for the purchase of 24 water pumps. In December, 1990, 18 months after the Project completion date, only 18 water pumps were received.

This operation was originated as follows:

- * DISABAR signed a contract with Wiese Representations S.A. dated August 14, 1987, following a Public Bid No.5-87 to purchase 24 water pumps for I/m. 4,573 equivalent to US\$ 123,600 (US\$ 37 X 1.00). The contract established that the water pumps would be delivered on December 31, 1987. The transaction was known and approved by USAID/PERU by letter dated August 5, 1987.
- * The company did not deliver the goods and afterwards (in 1988) charged DISABAR a higher amount to compensate for the variation of the

exchange rate notwithstanding that it had already received the payment in advance.

- * On September 29, 1990, DISABAR issued Resolution No.050-90 approving a new agreement with the supplier for the delivery of only 18 water pumps, instead of the 24 originally contracted in August 1987. The delivery took place between November 5, and December 5, 1990.
- * We did not find the documentation concerning the Public Bid containing the purchasing conditions and penalties in case of lack of compliance, as well as the economic studies and legal support which sustain the Agreement referred to in Resolution No. 050-90.

According to the terms of the Agreement and the amendment of Law IG of 1988, the goods purchased with the loan funds must be used during the term of the Project. This did not take place because the water pumps were received in December of 1990, after the Project's completion date (June 30, 1989).

On the other hand, the Guide for Financial and Financial Related Audits of AID-Financial Agreements quotes that the Amendment to Law IG of 1988 includes within the questionable costs the amounts spent unnecessarily or not used in the Project.

DISABAR officials did not adopt the necessary measures to oblige the supplier to deliver the goods on time, for their use according to the annual plan.

- b) Unsupported costs.- During the years 1982 to 1984, DISABAR made disbursements for an amount of US\$ 1,422,086. The corresponding supporting documentation were not found for their verification. Those funds are distributed as follows:

	US\$ Dollars
Loan	1,321,049
Grant	<u>101,037</u>
	<u>1,422,086</u>

These funds were remitted from USAID/PERU through the following documentation:

Public voucher-advance

		Amount in Dollars	
Number	Date	Loan	Grant
<u>YEAR 1982</u>			
527-8240	01.20.82	449,193.80	--
527-8209	06.15.82	--	12,763.84
527-1437	06.15.82	--	10,803.93
TOTAL 1982		449,193.80	25,567.77
<u>YEAR 1983</u>			
527-83246	09.01.83	25,445.29	--
527-84252	12.08.83	108,295.17	--
527-84053	12.02.83	89,996.11	--
527-84072	12.27.83	58,485.65	--
527-83653	01.14.83	--	456.49
527-8456	09.28.83	--	15,384.61
TOTAL 1983		282,222.22	15,841.10
<u>YEAR 1984</u>			
527-84-086	01.10.84	35,052.45	
527-84-130	02.20.84	76,287.62	
527-84-145	02.28.84	31,716.69	
527-84-217	03.27.84	24,059.64	
527-84-301	04.13.84	19,298.45	
527-84-2570	06.13.84	364,525.99	
527-85-1975	12.31.84	38,692.37	
527-841196	03.02.84		22,600.00
527-841370	03.26.84		9,537.90
527-843465	08.21.84		10,864.20
527-843729	08.31.84		16,625.62
TOTAL 1984		589,633.21	59,627.72
GENERAL TOTAL		1,321,049.23	101,036.59

As stated in the agreement and Implementation Letter No. 1 the supporting documentation should be filed by the implementing entity and kept at least 3 years after the completion date of the Project. In addition there are other rules stating that books and documents should be filed appropriately.

The aforementioned situation was originated because of the lack of controls in the transfer of documents between the various entities who were in charge of the Project and were responsible for their custody. Consequently it was impossible to find the supporting documentation.



Spear, Safer,
Harmon & Co.



**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT No.527-0221
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989**

REPORT ON INTERNAL CONTROL STRUCTURE

INDEPENDENT AUDITOR'S REPORT

1. We were engaged to audit the Fund Accountability Statement of Rural Water Systems and Environmental Sanitation Project, USAID/PERU 527-0221, implemented by the Government of Peru through the technical offices of the Ministry of Health from September 25, 1980 to June 30, 1989, and have issued our report thereon dated January 30, 1991, in which we disclaimed an opinion due to limitations in the scope of our work.
2. In planning and performing the audit of the Fund Accountability Statement of the Project, we considered the internal control structure of the Division of Basic Rural Sanitation - DISABAR, the entity in charge of the Project from 1987 until June 30, 1989, in order to determine our audit procedures for the purpose of expressing an opinion about the Fund Accountability Statement and not to provide assurance on the internal control structure. We could not evaluate the internal control structure of the former technical offices which were in charge of the Project.
3. The management of DISABAR and the former implementing entities were responsible to establish and maintain the internal control structure to manage the Project's operations during the term of the Project. In order to accomplish this responsibility, estimates and decisions by management are required to assess the expected benefits and related cost of internal control structure policies and procedures. The objectives of the internal control structure are to provide management with reasonable, but not absolute, assurance that the assets are being safeguarded against losses from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the fund accountability statement.
4. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

5. For the purpose of this report, we have classified significant internal control structure policies and procedures in the following categories:

- * budget and accounting
- * analysis and reconciliations
- * supplies
- * treasury
- * staff
- * evaluation and programming
- * supervision and implementation of work

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 the control risk.

6. We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgement, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the fund accountability statement. The most important matters are the following:

- a) There was no adequate accounting system for the preparation of the fund accountability statement. Nor was it adequately supported by books, records and documents duly processed. On the other hand, as a consequence of the lack of periodical audits during the term of the Project, no corrective measures were implemented to improve their operations.
- b) There were insufficient procedures in the warehouse to properly account for all the inventories. The following conditions regarding the warehouse were found:
 - 1. Lack of a perpetual inventory system, which could show the number of units on hand at their proper cost.
 - 2. Lack of periodical physical inventory to reconcile and update the perpetual inventory system.

These conditions, together with the lack of proper accounting system and books, did not allow us to verify the materials used, plus other related construction costs for each system built.

7. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
8. 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 in paragraph 7. However, we believe that the reportable conditions described above are material weaknesses.
9. We also noted other matters involving the internal control structure and its operation that we have reported to the management of DISABAR with Letter No.0054 of January 30, 1991.
10. This report is intended solely for the information and use of the United States Agency for International Development, the Ministry of Health and DISABAR. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

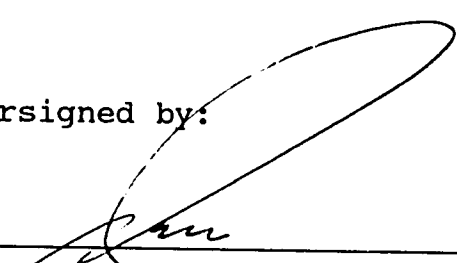
January 30, 1991

Spear, Safer, Harmon & Co.

Spear, Safer Harmon & Co.

Miami, Florida USA

Countersigned by:


Alberto Ramirez Enríquez (Partner)
Registered Peruvian Public Accountant
Register No. 2281

Ramirez Enríquez y Asociados

**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT NO.527-0221
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989**

REPORT ON INTERNAL CONTROL STRUCTURE

FINDINGS

01. LACK OF ORGANIZATION AND IMPLEMENTATION OF AN ACCOUNTING SYSTEM FOR THE PROJECT

Condition

DISABAR did not organize or implement an adequate accounting system to support the Fund Accountability Statement for the Project USAID/PERU 527-0221. DISABAR did not have accounting books and records nor a chart of accounts nor written procedures for processing the accounting information.

In our evaluation of DISABAR as a whole, we determined that the accounting system used was based on Accounting Standards of the Central Government, however, this system does not allow for independent verification of the Project because of the limited, incomplete and untimely records kept.

DISABAR set forth as a policy to prepare statements of liquidations, which its main purpose was to summarize the disbursements reports received from the "fronts" (administrative units for various localities where systems were installed). These reports from the fronts consisted of a listing of all costs incurred in the local communities and included the supporting documentation. The statement of liquidation also included the expenses of DISABAR's central office. These statements of liquidation were submitted to USAID/PERU by DISABAR as a liquidation of the advances received. Except for these statements, there were no other accounting records which could allow for the preparation of financial statements.

Any project with a volume such as this one, requires reliable and timely financial statements which would enable an evaluation of the results according to its cost and other criteria set by management.

Criteria

The Agreement in clause Sections B.5, Annex 2 and the Letter of Implementation No. 1 establishes that accounting books and records shall be kept for the Project, according to Generally Accepted Accounting Principles and that the Fund Accountability Statement had to be audited according to Generally Accepted Auditing Standards.

Cause

The reason for the aforementioned, in our opinion, is created by the following:

- * From the beginning of the Project it was accepted that DISABAR submits statements of liquidations to USAID/PERU based on certain pre-established procedures, notwithstanding that the Agreement established as a requirement to keep accounting records and books and to prepare financial statements according to generally accepted accounting principles. The Agreement also required that the financial statements be audited periodically.
- * The Project has been administered by different technical entities of the Ministry of Health:
 - Division of Sanitary Engineering-DIS (up to 1981, approximately).
 - Division of Rural Sanitation-DISAR (1981).
 - General Division of Environment-DIGEMA (From 1982 to 1985).
 - General Division of Construction (1986).
 - Division of Basic Rural Sanitation-DISABAR (From 1987 to 1989).

These entities were in charge for a determined period of the Project and none of them accumulated the relevant information and transferred it to the other, in such a way that it would be possible to design and implement an accounting system for the Project USAID/PERU No.527-0221.

- * If external auditors would have been engaged during the term of the Project (10 years) which was established by the Agreement and the Letter of Implementation No. 1, the lack of an accounting system would have been detected on a timely basis and the necessary corrective measures could have been taken.

Effect

The discussion above has produced the following effects:

- * Inadequate accounting and/or financial control of the Project which was limited exclusively to receive funds from USAID/PERU and to account for these funds by DISABAR.
- * Limitations to perform either financial or operative audits of the Project based on generally accepted auditing standards. During the 10 year term of the Project, no financial audit was performed. In 1988, Deloitte Haskins & Sells (Now Deloitte Ross Thomatzo International) performed a special examination which was limited to the evaluation of the internal control system and the review of the statements of liquidation and disbursement reports. Also, the General Comptroller of the Republic of Peru and the General Inspector of the Ministry of Health performed special examinations which included certain administrative aspects of DISABAR. However, these audits did not report on the accounting system and financial statements of DISABAR as the implementing entity of the Project.
- * Inadequate internal control structure because the accounting system is the fundamental basis to safeguard the assets and provide the financial information required by the Project administration.

Recommendation

We recommend that Ministry of Health design and implement a comprehensive accounting system which would allow for the independent verification of project expenses.

02. THE SURPLUS OF GOODS AND MATERIALS IN STORES AND WAREHOUSES ARE NOT ADEQUATELY CONTROLLED

Condition

We made a physical inspection of the surplus of goods and materials located in the different stores and warehouses and found weaknesses on the internal control structure, which are summarized as follows:

- * The surplus which include goods and materials located in different warehouses are unknown and have not been valued. The main office does not know of the goods and material located in 18 "fronts" (administrative units for various localities where the systems were installed).

The lack of an accounting system prevents the identification and valuation of these properties.

- * We have not found evidence of physical and valued kardex (bincard) system in which goods and materials could be identified as to its age, purchase cost and the balances not used. Normally, the kardex is a part of an accounting system, however, as stated above, a proper accounting system for this Project was not implemented.
- * There are no adequate safety measures. For example: in the main office's warehouse, where there is the greatest amount of surplus goods, the main door and the walls are not well protected. There is a similar situation in other warehouses visited (Ica, Puno, Arequipa, Cajamarca, Piura). We found that in the main office's warehouse, on February 14, 1986, there was a robbery and in the Ica's warehouse on October, 1990, some goods were stolen due to inadequate safety measures. After informing the police authorities, we found that no further action was taken to recover those goods.

Additionally, we have determined that the stores and warehouses were not insured. During the term of the Project no insurance policy was taken with this purpose.

Criteria

According to internal control standards and policies, the surplus represents assets of the implementing entity, which shall be duly protected and safeguarded through procedures and practices of internal control that DISABAR has not organized and implemented adequately.

According to the Agreement, the Government of Peru is obliged to assure the maintenance of the systems built with funds of the Project, however, we have not identified or seen any policies for the use of the Project's surplus of goods and material.

Cause

The reason for the conditions discussed above is the lack of coordination between the officials of DISABAR and USAID/PERU, in determining an adequate management policy for the proper use of the surplus. Another reason that makes the situation worse is that DISABAR does not know the amount of goods and materials remaining from the Project due to the lack of a proper accounting system and internal control procedures.

Effect

The above conditions create a potential risk to the surplus of goods and materials, due to the possibility of losses and/or deterioration. On the other hand, due to the lack of proper planning and decision making by the DISABAR officials, the surplus of goods and materials are not properly utilized in the maintenance of the systems built with the Project funds.

Recommendation

We recommend that the authorities of the Ministry of Health order the taking of a physical inventory of all the surplus of goods and materials and propose a policy that would enable its use in the maintenance of the systems, as required by the Agreement. Additionally, DISABAR should acquire insurance coverage for the Central Office Warehouse, where the greatest amount of surpluses are kept.

03. WEAKNESSES INTERNAL CONTROL IN THE MOVEMENT OF GOODS AND MATERIALS OF THE Project

Condition

In our examination we have determined the following situations:

- * The warehouse receiving and shipping reports are not prepared and registered adequately: (1) the shipping report does not have a date nor the signature of the warehouse supervisor documenting his approval; (2) there is no recording of the shipment in the bincards; (3) shipment notices issued by the warehouse and signed by the drivers to control the shipment of goods and materials are destroyed.
- * Goods and/or materials were delivered to programs or entities that have nothing to do with the Project, without recording nor controlling it to assure their recovery.

Reference:

- Delivery of goods and materials to other programs not supported with shipping reports.

Delivery Note	# of document	Date	Goods and materials loaned	Program
167	DSPO-956-87	01.09.87	295 tubes 1 1/2"x6 PVC 398 tubes 1/2" x 6 PVC 477 Elbows 1/2 x 90° PVC 5 Elbows 1 1/2"x45° PVC 159 Tees 1 1/2"x1/2" PVC 318 Connector Bolt RML 0 1/2" PVC 3 Floating Valves 1 1/2" of bronze with float and rod	IV Phase
139	DSPO-0935-88	17.08.88	237 Tubes de 1" x 6 m. 3 Elbows 1" x 90° PVC 6 Elbows 3" x 90° PVC 2 Tees 1" x 1" PVC	Recovery of systems

* No physical inventory was taken of the goods and materials in the warehouse for the years from 1982 to 1988, and for the year 1989.

* The purchase orders when used as a source of entry information to the warehouse are not reviewed by the office of budget and accounting. Therefore, it is impossible to control the budget and determine when the respective funds will be needed.

Criteria

An adequate internal control structure should enable an entity to take practical measures to assure the control of its stock. Proper measures normally include receiving and shipping reports in order to determine the amounts used and the final balances. Such inventory records provide a basis of accountability that allows the use of verification tests. After analyzing and reaching conclusions on the tests' results, corrective measures can be determined to eliminate problems that come up.

Cause

The cause of the above mentioned deviations is the lack of supervision and control, as well as lack of guidelines and procedures for the operative personnel.

Effect

These limitations in the accounting system of each Project prevents the identification of the quantities and costs of goods and materials used in the water systems built. This deficiency is one of the reasons that the cost of each water system can not be calculated with accuracy.

Additionally, the implementing entity does not have any assurance that the goods and materials received and shipped were accounted for properly.

Recommendation

We recommend that in the future the implementing entity have a minimum structure of internal control, to assure an adequate control of the project goods and materials.

04. THE PROGRESS REPORTS DO NOT HAVE SUPPORTING DOCUMENTATION AND RELIABLE DATA

Condition

During the term of the Project and according to the implementation plans, the entity should have prepared each year a plan of action outlining the activities to be performed with the approval of USAID/PERU and based on the amount of funds available under the Agreement.

We have observed that the Evaluation and Programming unit of DISABAR did not have supporting documentation for the criteria which originally determined the goals and objectives for each of the locations in the Regions, as well as the activities to be performed.

In our examination, we determined that the progress reports were not based on evaluation of data prepared by technical and/or financial entities using pre-established criteria. These reports did not explain the causes for variations between what was approved according to the plan of action and the results obtained.

The progress reports did not contain information with respect to water systems and latrines built, domiciliary connections, public faucets, etc. In certain cases in which the information is available, the exhibits are not in accordance with the actual results, as we could see in our visits to Puno and Arequipa.

Criteria

At the end of each quarter, according to the Agreement, DISABAR should have prepared a progress report with the results of the activities performed and included in the plan of action.

Under the point of view of internal control it is necessary that all documentation which support goals and activities (Plan of Action) as well as the follow-up and evaluation of results (Progress Report) be adequately documented with actual figures with the purpose of evaluating subsequently the reliability of goals and activities achieved, as well as the corresponding costs, aspects which we could not determine in our examination.

Cause

The reason for the unsupported progress reports is due to the lack of methodology, guidelines and interest shown by the officials to back up the results of the activities with sufficient and reliable documentation.

Effect

As a consequence of these procedures the progress reports were of limited use for measuring and evaluating the progress of the Projects.

Recommendation

We recommend that in the future the implementing entity prepare progress reports according to an adequate methodology which would assure the fulfillment of the goals identified in the plans of action. As part of an effective internal control structure, these reports should be evaluated on a timely basis to determine their accuracy.

05. LACK OF PHYSICAL CONTROL OF FIXED ASSETS PURCHASED WITH Project FUNDS

Condition

We have determined that the fixed assets purchased with Project funds were not adequately controlled. We were unable to find a listing showing in a complete and reliable form the total fixed assets and their location. DISABAR has a record in which it is impossible to identify with reasonable assurance the Project's assets.

In our examination we determined that DISABAR, due to a request from the General Division of National Investment

Services of the Ministry of Health, authorized in February of 1990 a loan of 3 theodolites for the topographical measurement of hospitals at Puno, Chachapoyas and Ayacucho. In our analysis we could not find the recording of the shipment nor the documentation that would assure its recovery nor date of its return.

Criteria

There should be an appropriate control with the purpose of safeguarding and identification of their location at all times.

Cause

This deficiency is due to a lack of an accounting system as a basis for the issuing of financial statements according to generally accepted accounting principles. The accounting done by DISABAR is incomplete because it does not accumulate all the information related to the Project prior to 1987. As stated before, the Project was managed by other technical entities of the Ministry of Health. These entities did not, also, have any policy on the use of fixed assets.

The implementing entity does not have a complete and reliable record of the fixed assets purchased during the term of the Project, which would indicate its characteristics, values and location.

Effect

The accounting system does not provide assurance that these assets could be identified and located.

Recommendation

The Ministry of Health should request DISABAR to take a physical inventory of all the fixed assets purchased with Project funds. The inventory should include information as to technical specifications, date of purchase, market value and actual condition. The listings of fixed assets should also be reconciled with disbursements made by USAID.

06. SOME LOCATIONS DID NOT RECEIVE GOODS AND MATERIALS ACCORDING TO THE 1987 PLAN OF ACTION

Condition

As part of our examination we evaluated the distribution of the goods and materials to the locations and we have observed that during 1987 these locations did not receive the following goods and materials as approved in the plan of action.

Reference:

<u>Office</u>	<u>Goods and materials</u>
Trujillo-Huamachuco	2 station wagons
Ancash-Huari	1 station wagon
Ayacucho	11 different tools
Piura	1 theodolite
Huari	2 equipments hash-milipone
Huamachuco	1 Motor perforator
Lima	2 Motor perforators

Criteria

The plan of action for each year determines the goals and objectives to be accomplished. The plan describes the human and physical resources to accomplish such goals.

Cause

Our analysis showed that the goods were used in other units of the Project. These goods did not reach certain locations because the main office of DISABAR changed their usage as stated in the plan of action. Furthermore, the progress reports did not reveal these changes.

Effect

The above observations resulted in the regional offices not accomplishing all the goals and objectives stated in the plan of action.

Recommendation

In the future the Ministry of Health should require the implementing entity to include in their progress reports, the causes and effects that are created when a location does not receive the goods and materials as originally projected.

07. WEAKNESS ON THE CONTROL OF DISBURSEMENTS AND LIQUIDATION TO AND FROM DISABAR

Condition

In the evaluation of the internal control structure in this area, we have determined the following situations:

- * Duplication by DISABAR in the preparation of summary disbursement reports, which serve as a basis to prepare the statements of liquidation with USAID.

- * In some cases, the summary of the disbursement reports do not coincide with the disbursement reports and do not include all the supporting documentation.
- * Payroll outflows verified on a test basis, in some cases do not have the attendance record and in other cases there is no evidence of approval by the responsible supervisor.
- * Payment receipts which have neither the signature of the treasurer, the chief accountant nor the director.
- * Payment receipts without the signature of the recipient of the money.
- * Summary of disbursement reports which do not coincide with the date on the record of remittances kept by DISABAR. In other cases, the summary of disbursements do not agree with the amounts shown in the supporting documentation.

Criteria

According to the procedures established, DISABAR distributes the funds from USAID/PERU to the locations according to the requirements established in the plans of action. Afterwards, the locations deliver to DISABAR documentation supporting the disbursements. From this information DISABAR prepares the statements of liquidation which are sent to USAID for approval.

Cause

These weaknesses are due mainly to the lack of assignment of duties and responsibilities. The department of analysis and reconciliation of disbursements is responsible for preparing and reviewing the statements of liquidation. Nevertheless, no supervision function was performed by officials in charge of the internal control.

During our examination we found that the findings and recommendations made by the firm Deloitte Haskins & Sells regarding weaknesses in the internal control system and the statements of liquidation were not implemented, nor the deficiencies which originate them corrected.

Effect

Weaknesses on internal control related with the fund outflow could originate deterioration on cash procedures with the corresponding contingencies for the entity in charge of the fund and cause a material damage to the Project itself.

Recommendation

The implementing entities should outline basic procedures to be fulfilled inside an internal control structure, and consider subsequent supervision and inspection in order to safeguard the project's fund.



Spear, Safer,
Harmon & Co.

**RAMIREZ
ENRIQUEZ Y
ASOCIADOS**
Contadores Públicos 

**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT NO.527-0221
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989**

**COMPLIANCE WITH AGREEMENT TERMS, PROJECT IMPLEMENTATION
LETTERS, AND APPLICABLE LAWS AND REGULATIONS**

INDEPENDENT AUDITOR'S REPORT

1. We were engaged to audit the Fund Accountability Statement of the Rural Water Systems and Environment Sanitation Project USAID/PERU 527-0221 implemented by the Peruvian Government through technical entities of the Ministry of Health for the period from September 25, 1980 to June 30, 1989, and have issued our report thereon dated January 30, 1991, in which we disclaimed an opinion due to limitations in the scope of our work.
2. The compliance with laws, regulations, contracts and grants applicable are the responsibility of the Peruvian Government through the technical entities of the Ministry of Health which during the period September 25, 1980 to June 30, 1989, were in charge of the Project's management. With the purpose of obtaining a reasonable assurance about whether the Fund Accountability Statement is free of material misstatement, we performed tests of compliance by the Ministry of Health with agreement terms, laws and regulations which may affect the Project's goals and incurred costs. However, our objective was not to express an opinion over the total compliance of such terms.
3. Material instances of non-compliance are failures to follow requirements, or violations of prohibitions, contained in statutes, regulations, contracts or grants that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Fund Accountability Statement. The results of our tests of compliance disclosed the following material instances of non-compliance, the effects of which have not been corrected in the Rural Water System and Environmental Sanitation Project's Fund Accountability Statement for the period September 25, 1980 to June 30, 1989.
 - a) The Project does not keep accounting books and records from which financial statements could be prepared on a regular basis, according to generally accepted accounting principles. These financial statements were required to be audited on a regular basis according to generally accepted auditing standards. As well, the supporting

documentation for the Project's funds was not properly ordered, classified and accessible for review. This situation does not comply with Section B.5 Reports, Records, Inspections, Audits of Annex 2 to the Agreement and Letter of Implementation No. 1.

- b) There are questionable costs of US\$ 123,600 that do not comply with Section 7.2 of the Agreement, which requires that goods and services acquired with funds from the loan and grant be used exclusively in the Project. This matter was disclosed in the Fund Accountability Statement on page 14 and footnote 5-a on page 19.
- c) There is no supporting documentation for disbursements made from 1982 through 1984 amounting to US\$1,422,086. These funds could be classified as unsupported costs by USAID. This is a lack of compliance of Section B.5, Report, Records, Inspections, Audits of Annex 2 to the Agreement and the Letter of Implementation No.1. This matter was disclosed in the Fund Accountability Statement on page 14 and footnote 5-b on page 20.
- d) The progress reports issued on a periodical basis did not contain all the information necessary for a complete evaluation of the Project, not complying with section 6.5 of the Agreement.
- e) The Peruvian Government did not provide the total funds as stated in the agreement and the implementing plan due to delay in the execution of the Project. Consequently the goals were not fulfilled as established. This matter was disclosed in the Note 4 to the Fund Accountability Statement on page 18.

We considered these material instances of non-compliance in forming our opinion on whether the Rural Water Systems and Environmental Sanitation Project's Fund Accountability Statement is presented fairly, in all material respects.

- 4. Except as describe above, the results of our tests of compliance indicate that, with respect to items tested, DISABAR and other implementing entities of the Project complied, in all material respects, with the provisions referred to in Paragraph 2 of this report and with respect to items not tested, nothing came to our attention that caused us to believe that DISABAR and other implementing entities had not complied, in all material respects, with those provisions.

5. This report is intended solely for the information and use of the Ministry of Health of Peru and the U.S. Agency for International Development. This restriction is not intended to limit the distribution of this report which upon acceptance of the Office of the Inspector General, is a matter of public record.

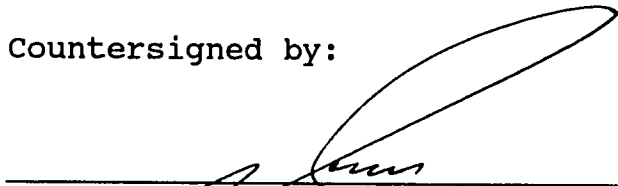
January 30, 1991

Spear, Safer, Harmon & Co.

Spear, Safer Harmon & Co.

Miami, Florida USA

Countersigned by:



Ramírez Enríquez y Asociados

Alberto Ramírez Enríquez (Partner)
Registered Peruvian Public Accountant
Register No. 2281

**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT
MANAGED BY THE MINISTRY OF HEALTH OF PERU
USAID/PERU PROJECT NO. 527-0221
FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989**

**COMPLIANCE WITH AGREEMENT TERMS, PROJECT IMPLEMENTATION
LETTERS, AND APPLICABLE LAWS AND REGULATIONS**

FINDINGS

1. THE PERUVIAN GOVERNMENT CONTRIBUTION WAS LESS THAN STATED IN THE LOAN AND GRANT AGREEMENT AND THE FINANCIAL PLAN.

Condition

The Peruvian Government provided funds as national counterpart in local currency (intis). The actual amount contributed of US \$3,465,844 was less than the established amount in the loan and grant agreement.

The smaller contribution by the Peruvian Government resulted in a lack of compliance with the mentioned agreements. The following is a summary of the government counterpart compared with the amount budgeted, expressed in dollars for comparative purposes, using the average exchange rate at year end.

<u>Categories of Investments</u>	<u>In U.S. Dollars</u>		
	<u>Budget</u>	<u>Receipts</u>	<u>Disbursements</u>
Constructions	1,854,000	34,498	34,498
Vehicles and equipment	-	3,150	3,150
Support expenses	2,817,000	3,206,532	3,206,532
Others	449,000	-	-
Sales Tax	<u>80,000</u>	<u>221,664</u>	<u>221,664</u>
Total	<u>5,200,000</u>	<u>3,465,844</u>	<u>3,465,844</u>

Criteria

According to the Agreement and its amendments, the Peruvian Government agreed to contribute no less than US \$4,731,000. Such contribution according to the financial plan, as prepared by the administrative entity and approved by USAID/PERU, was subsequently increased to US \$5,200,000.

Cause

The smaller contribution was caused principally by a delay in the start up of the project of approximately fifteen months.

Effect

This lack of compliance made it impossible to reach the established goals since the funds were not accessible as required by the Agreement and its amendments.

Recommendation

The Peruvian Government should consider for future projects the fulfillment of the agreements signed with international organizations as USAID as it concerns the contribution of the national counterpart in order to allow for the proper financing of the projects.

ANNEX 1

**THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION
PROJECT MANAGED BY THE MINISTRY OF HEALTH
OF PERU USAID/PERU PROJECT NO.527-0221**

FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989

MANAGEMENT COMMENTS:

The General Director of the Division of Basic Rural Sanitation-DISABAR, entity of the Ministry of Health and responsible for the project administration expressed the following comment, "we do agree with the audit report and my office will proceed with the implementation of the stated recommendation according to our capabilities and in such a manner that they allow us to improve the administration of future projects financed by the Agency for International Development, USAID."

In relation to the lack of supporting information for the loan and grant disbursements of US\$ 1,321,049 and US\$ 101,037 respectively, we wish to mention that the original documentation was presented to USAID, they verified all that documentation before their approval for such expenses.

Regrettably, subsequent administration of the project by other entities of this Ministry, made it impossible to obtain such documentation, nevertheless we will rebuild that information to whatever extent is possible (page 12 of the audit report).

Regarding the purchase of the water pumps, these were received after the end of the project and our institution will use them on complementary activities. This situation was originated due to administrative difficulties and to supplier's delay (page 13 of the audit report).

ANNEX 2

THE RURAL WATER SYSTEMS AND ENVIRONMENTAL SANITATION PROJECT MANAGED BY THE MINISTRY OF HEALTH OF PERU USAID/PERU PROJECT NO.527-0221

FOR THE PERIOD FROM SEPTEMBER 25, 1980 TO JUNE 30, 1989

LISTING OF RECOMMENDATIONS:

01. The authorities of the ministry of Health should design and implement a comprehensive accounting system with the purpose of allowing the independent verification of project expenses (finding 01, on page 25).
02. We recommend the taking of a physical inventory of all the surplus of goods and materials that can be used in the maintenance of the systems, and additionally acquire insurance coverage for the warehouses (finding 02, on page 27).
03. The implementing entity should establish a minimum structure of internal control for the movement of goods and materials used in the project (finding 03, on page 29).
04. Progress reports should keep an adequate methodology to assure the evaluation and follow-up of activities performed, as well as the fulfillment of the goals identified in the plans of action (finding 04, on page 31).
05. All fixed assets purchased should be inventoried and reconciled with disbursements made by USAID (finding 05, on page 32).
06. The implementing entity should provide the local units with the goods and materials according to the plan of action, and include in their progress report causes and effects created when a location has not received those materials as originally projected (finding 06, on page 33).
07. The implementing entity should outline basis cash procedures for the control of disbursements and liquidations and their subsequent supervision in order to safeguard the project's funds (finding 07, on page 34).
08. The Peruvian Government should consider for future projects the fulfillment of the agreements signed with international organizations as USAID, relating to the contribution of the national counterpart in order to allow for the proper financing of the projects (lack of compliance disclosed on page 40).

APPENDIX

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