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**REVIEW OF THE COMMODITY
MANAGEMENT SYSTEM OF THE
NATIONAL RAILWAYS OF
EL SALVADOR (FENADESAL)**

**Public Services Improvement Project (PSIP)
Project No. 519-0320-I-00-1067-00
Delivery Order No. 10**

**Final Report
April 29, 1994**

Price Waterhouse



April 29, 1994

Armand Lanier
Audit Management Officer
Office of the Controller
U.S. Agency for International Development
Mission to El Salvador
San Salvador, El Salvador

Dear Mr. Lanier:

Attached please find the Price Waterhouse final report on the Review of the Commodity Management System of the National Railways of El Salvador (FENADESAL), for the Public Services Improvement Project (PSIP) (519-0320).

This review was performed in accordance with the Statement of Work Contract No. 519-0320-I-00-1-67-00, Delivery Order No. 10.

We would like to extend our appreciation to your office for the support provided during the performance of this engagement. Should you wish to contact us, please feel free to call Mr. Oscar Cordon in (503) 790 - 745, or Ms. Bettina Garcia Welsh at (202) 861 - 6263.

Sincerely yours,

Bettina Garcia-Welsh for O.C.

Oscar Cordon
Price Waterhouse

PD-ABS-479

FINAL REPORT

**REVIEW OF THE COMMODITY MANAGEMENT SYSTEM
OF THE NATIONAL RAILWAYS OF EL SALVADOR
(FENADESAL)**

**PUBLIC SERVICES IMPROVEMENT PROJECT (PSIP)
PROJECT No. 519-0320**

ENGLISH/APRIL 29, 1994

**Prepared for:
U.S. Agency for International Development
Mission to El Salvador
Office of the Controller**

**Prepared by:
Price Waterhouse**

**Performed under:
Contract No. 519-0349-I-00-1067-00
Delivery Order No. 10**

**REVIEW OF THE COMMODITY MANAGEMENT SYSTEM
OF THE NATIONAL RAILWAYS OF EL SALVADOR (FENADESAL)**

**PUBLIC SERVICES IMPROVEMENT PROJECT (PSIP)
PROJECT NO. 519-0320**

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**REVIEW OF THE COMMODITY MANAGEMENT SYSTEM
OF THE NATIONAL RAILWAYS OF EL SALVADOR (FENADESAL)
(FENADESAL)**

**PUBLIC SERVICES IMPROVEMENT PROJECT (PSIP)
PROJECT NO. 519-0320**

I. Introduction

A. Program Background

On August 30, 1989, AID signed the Public Services Improvement Project No. 519-0320 with the Government of El Salvador's (GOES) Ministry of Planning and Coordination for Social and Economic Development (MIPLAN). The general purpose of the Project is to support the restoration of services interrupted and facilities damaged or destroyed as a result of the insurgent activity or natural disaster in El Salvador. The original amount of the Project was for US\$ 75 Million in grant funds including US\$28,900,000 for commodities to be purchased using host country procurement and fixed price contracting by Louis Berger International, Inc. (LBII). The agreement is effective for a period of five years, ending September 30, 1994.

The grant agreement established that the GOES would provide \$60 Million in counterpart contribution including ESF and PL-480 Title I generated local currency.

USAID's Major Infrastructure Division supervises the activities of the PSIP program. On behalf of the GOES, eight entities are in charge of implementing project activities, which includes MIPLAN and the Secretaria Tecnica del Financiamiento Externo (SETEFE) as administrative entities and the following six executing entities:

- Machinery and Equipment Administration (AME)
- National Administration of Aqueducts and Sewage (ANDA)
- Lempa River Hydroelectric Executive Commission (CEL)
- Autonomous Ports Executive Commission (CEPA)
- Roads and Highways National Directorate (DGC)
- El Salvador National Railways (FENADESAL)

The three specific purposes of the project are to:

- Restore and preserve vital public services provided by the infrastructure agencies
- Improve and sustain access of rural populations to markets

- Increase access to potable water supply for rural populations, and increase the proper utilization of water and sanitation systems.

The project has four components each designed to achieve the purposes stated above, as follows:

- Component I: Public Services Restoration
- Component II: Secondary, Tertiary, and Lower Class Rural Road Deferred Maintenance and Repair
- Component III: Potable Water Supply, Sanitation, and Health
- Component IV: Institution Strengthening Technical Assistance, Project Support, and Monitoring and Evaluation
- Component V: Post War Maintenance, Repair, and Reconstruction

B. FENADESAL's Participation

The Project objectives in connection with El Salvador National Railways (FENADESAL) are covered by three (3) phases, with the first two attempting to rehabilitate track conditions and railway equipment with a view to restore the good working order and safety of trains and provide better service to the community. The third phase includes three sub-projects:

1. Improvement of track drainage, visibility and safety.
2. Repair and protection of bridges and sewerage.
3. Reconstruction of the rolling stock.

El Salvador National Railways (FENADESAL) is the successor of The El Salvador Railways Company, which was taken over by the GOES in 1975 and whose former name until 1900 was the Acajutla Railways Company, founded in 1882 by British interests. The administration, operation and management of FENADESAL is under the Autonomous Port Executive Commission (CEPA), an autonomous public service entity.

The railways network of El Salvador includes a railway track divided in three districts: District 1 covering the San Salvador-Zacatecoluca-San Miguel-Cutuco Port segment (with direct access to the two berths of the latter); District 2 covering the San Salvador-Textistepeque-Santa Ana segment and from here to La Virgen, border with Guatemala, where it connects with the Guatemalan Railways toward the Atlantic Coast; and District 3 covering the San Salvador-Santa Ana segment.

In spite of the poor conditions in which the railroad resumed its operations, given the physical deterioration in which it was left by its former owners, as well as due to the development of the national road network initiated in the 1950s as an additional transportation alternative, FENADESAL freight and passenger operations were steady until 1980, when the rise of the armed conflict made the entity a military objective for the guerrilla, in which the railroad system was the most damaged within the national transportation sector.

Up to now, FENADESAL receives subsidies for its operation, which limits the establishment of controls and the establishment of its goals and objectives.

C. Objectives, Scope and Methodology

1. Objectives of Commodity Management System Review

The objective of the commodity management system review is to report on whether FENADESAL's system in place is adequate and reliable to properly account for all commodity transactions such that the Controller's Office at USAID/El Salvador can issue a certification of the system. The specific objectives of this review were to:

- Obtain an understanding of FENADESAL's commodity management system and assess the control risk.
- Perform tests of the systems and other procedures related to commodities purchasing, customs clearance, receiving and inspection, claims, warehousing, transfers, issuance accounting records, reporting, non-expendable property management, and end-use verification to determine whether 1) the actual procedures performed are the same as prescribed, and 2) the organization is complying with agreement terms and conditions.
- Complete the "Basic Standards for Evaluating Entity's Commodity Management System" checklist.

- Determine whether FENADESAL has undergone previous commodity management system studies and whether it has taken adequate corrective actions on prior audit report recommendations related to commodities.

Our objective was not to audit, examine, and render an opinion on FENADESAL's financial statements.

2. Scope of Commodity Management System Review

The review of FENADESAL's Commodity Management System was performed in accordance with generally accepted auditing standards, the U.S. Comptroller General's "Government Auditing Standards" (Yellow Book, 1988 Revision), and the USAID/EL Salvador "Basic Standards for Evaluating Entity's Commodity Management System".

The scope of this review included the books and records, policies and procedures, organizational structure, and personnel and facilities of FENADESAL's implementing units.

3. Methodology of Commodity Management System Review

The review procedures performed were designed to achieve the stated objectives, through reading the relevant documents, performing selective tests, conducting interviews, and conducting physical observations.

We reviewed the Project Paper, the Grant Agreement including all amendments, the contract between USAID/El Salvador and Louis Berger International, Inc., all Project Implementation Letters (PILs), the annual plans, budgets, action and procurement plans, applicable OMB Circulars, AID Handbooks (1B, 3, 11, 14, and 15), SETEFE Guide 1262, periodic project reports, all prior reviews of FENADESAL's commodity management system, and FENADESAL's purchasing, receiving and inspection, warehousing and issuance, and general operations policies and procedures. Based upon these documents, we identified the agreement terms and applicable laws and regulations where noncompliance could have a material effect.

We secured an understanding of the design and operation of FENADESAL's commodity management system and its internal control structure through the review of FENADESAL manuals and interviews with USAID/El Salvador and FENADESAL personnel. To confirm our understanding of the design of the system and its operating procedures, we performed "walk-throughs" of transactions. Based upon the established policies and procedures, we assessed control risk.

In order to confirm that actual practices are in conformity with the prescribed procedures, we selectively tested transactions at FENADESAL project offices, USAID/El Salvador, and the warehouses visited. (See Appendix I for a list of the warehouses physically inspected.)

The findings and recommendations of prior reviews of the FENADESAL's commodity management system were discussed with both USAID/El Salvador and FENADESAL to ascertain if these prior findings had been resolved and the recommendations addressed. FENADESAL's comments to our draft report are included in Appendix VII.

D. Summary of Review Results

The findings and recommendations of FENADESAL's commodity management system (SABM) review are presented in three substantive areas: Internal Control Structure, Compliance with Agreement Terms and Applicable Laws and Regulations, and Status of Prior Review Recommendations. The detailed findings are presented in the corresponding sections of this report, and are summarized below.

Some of our observations may be classified in more than one area of the report. For instance, the deficiencies in the storage of goods could represent a weakness in the internal control structure, as well as a case of noncompliance with the USAID grant agreement. In this report, we have made reference to the finding when the same appears in a previous section of the report. In other cases, we have repeated the finding when, in our judgment, doing so facilitates the presentation of the condition and the recommendation.

1. Commodity Management System Internal Control Structure

The review of the Commodity Management System internal control structure of FENADESAL identified reportable conditions that we believe impact FENADESAL's capability to adequately manage project commodities. These reportable conditions relate to deficiencies in procedures manuals, warehousing organization and operations, maintenance of accounting records, and information systems. The reportable conditions listed below are discussed in detail in Section II.B.:

- FENADESAL should improve the definition and assignment of responsibilities for the custody of the goods and attain a more effective segregation of duties.
- FENADESAL does not have a document duly approved by USAID/El Salvador related to the inventory administration system.

- Deficiencies were identified in FENADESAL warehouses related to inventory and kardex cards control.
- The physical conditions of some warehouses do not offer adequate protection or segregation for the fixed assets purchased under the project.
- Some of the project reports and fixed asset inventory listings for assets purchased under the project are improvised and are not reliable.
- FENADESAL does not have adequate insurance coverage on the warehouses and their contents.

2. Commodity Management System Compliance with Agreement Terms and Applicable Laws and Regulations

FENADESAL's commodity management system is affected by the lack of compliance with certain agreement terms and applicable laws and regulations. These instances of noncompliance relate to deficiencies in the administrative procedures manual, warehousing operations, insurance, receipt of goods, training and personnel development, and information systems, as noted above. In some cases, we have repeated a finding from a previous section because the observed condition affects the internal control structure as well as being an instance of noncompliance. In section II.B. of this report, we discuss in greater detail the instances of noncompliance that were identified, as summarized below:

- Fixed assets or goods which have not been identified by the USAID logo or label.
- Goods acquired and paid directly by USAID/El Salvador which have not been completely accounted for.
- FENADESAL does not have adequate insurance coverage on the warehouses and their contents.

3. Status of Prior Review Recommendations for the Commodity Management System

This section of the report includes the recommendations made during prior reviews or consulting engagements, which have not been fully implemented or have not been executed consistently, which in our judgment affects the administration ability of FENADESAL in connection with the Project. The pertinent recommendations were related to deficiencies in

the procedures manuals, warehousing operations, and reports or information systems. For instance, FENADESAL already relies on the recommended procedures manual for warehouse operations, but has not yet been able to standardize procedures. As another example, we could mention that the computer in line with the CEPA systems has been installed since October 1993, but it still is not able to readily transmit the warehouse data to the units requiring them, due to the lack of the necessary human resources to do it. Finally, a review was made of the warehouse materials to identify obsolete materials for their sale, but the recommendation is not considered fully implemented because disposal of these materials requires much processing, which implies that the materials already identified can be gathered, while others may be added to the listing when the sale of the first batch is completed.

Section IV of this report describes those recommendations that we consider have not been fully implemented by FENADESAL.

E. FENADESAL Management Comments

In an exit conference held with FENADESAL and USAID/El Salvador representatives on March 7, 1994, to discuss in detail the contents of the draft report, there was general agreement with respect to our findings and recommendations. FENADESAL's written comments are included as Appendix VI.

F. Conclusions on FENADESAL Commodity Management System

Our evaluation procedures revealed significant reportable conditions in the internal control structure, instances of noncompliance, as well as recommendations of previous reviews that have still not been fully implemented, so it cannot be ensured that FENADESAL has, as of the date of our review, the administrative tools and controls necessary to permit adequate management of project commodities under the "Public Services Improvement Project", USAID/El Salvador project number 519-0320.

Therefore, the USAID/El Salvador Controller's Office may be able to make a provisional certification on the CEPA commodity management system once FENADESAL, under the supervision of USAID/El Salvador's Major Infrastructure Division, has confirmation of a specific action plan to implement the noted recommendations and has made significant progress in resolving the reportable conditions.

II. Internal Control Structure

A. Independent Consultant's Report on the Internal Control Structure

We conducted a review of the Lempa River Hydroelectric Executive Commission (FENADESAL) commodity management system that we considered relevant to the criteria established by USAID, as set forth in the grant agreement for the Public Services Improvement Project (PSIP), USAID/El Salvador Project No. 519-0320, and in our statement of work effective November 8, 1993. Our review included tests of compliance with such procedures. Our review did not constitute an audit of any financial statements prepared by FENADESAL.

We conducted our tests in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the tests to obtain reasonable assurance about the internal control structure of the Commodity Management System, and therefore, in planning and performing our tests of FENADESAL's Commodity Management System for the PSIP Project, we considered its internal control structure.

The management of FENADESAL is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an 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 authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. 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.

For purposes of this report, we have classified the significant internal control structure policies and procedures into the following categories: 1) planning and procurement of commodities, 2) receipt, customs clearance, and inspection of commodities, 3) warehouse records and controls, 4) physical safeguards, and 5) distribution of commodities to end users.

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 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.

The following are the reportable conditions observed in our review according to this criteria:

- FENADESAL should improve the definition and assignment of responsibilities for the custody of the goods and attain a more effective segregation of duties.
- FENADESAL does not have a document duly approved by USAID/El Salvador related to the inventory administration system.
- Deficiencies were identified in FENADESAL warehouses related to inventory and kardex cards control.
- The physical conditions of some warehouses do not offer adequate protection or segregation for the fixed assets purchased under the project.
- Some of the project reports and fixed asset inventory listings for assets purchased under the project are improvised and are not reliable.
- FENADESAL does not have adequate insurance coverage on the warehouses and their contents.

A material weakness is a reportable condition in which the design or operation of one or more of the 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.

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, however, that the reportable conditions our review identified are deemed to be material weaknesses.

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

Price Waterhouse

January 14, 1994
San Salvador

II. Internal Control Structure

B. Findings and Recommendations

1. ***FENADESAL should improve the definition and assignment of responsibilities for the custody of the goods and attain a more effective segregation of duties.***

Condition:

Responsibility for the custody of goods is not adequately defined and segregated, since the receipt of goods is signed by the department chief, notwithstanding the fact that it is the warehouse manager who is responsible for the control over the inventories. In addition, there is no document describing the inventory administration system to inform the applicable staff.

Criteria:

In accordance with OMB Circular A-123, section 5(d), "Internal Control System," a strong internal control environment should have adequate documentation relating to the system and should include manuals with policies and procedures, organizational charts, flowcharts and all the necessary related documentation to describe the organizational structure of the entity. It should also include operational and administrative procedures to communicate responsibilities and levels of authority among the staff, to comply with programs and objectives of the institution and to facilitate the training of new staff.

Cause:

The duties in the inventory area were defined by CEPA at the time. The lack of enough duly trained human resources, however, has not made it possible to perform reviews of the organizational structure for its modernization. The changes and the ability to obtain resources are subject to CEPA's approval, from which FENADESAL administratively depends.

Effect:

The possibility that errors and irregularities may occur and not be detected in a timely manner by FENADESAL officials and employees during the normal course of their assigned duties.

Recommendation:

FENADESAL should perform the necessary studies to achieve modernization of functions under an adequate segregation (of duties) system, assigning responsibility to different individuals with respect to custody, recordkeeping, and other decisions with respect to Project inventories.

- 2. *FENADESAL does not have a document duly approved by USAID/El Salvador related to the inventory administration system.***

Condition:

There is no document duly approved by USAID/El Salvador fully describing the inventory administration system, for information and reference purposes for the applicable staff.

Criteria:

OMB Circular A-123 "Internal Control System", Section 5(d) refers to the documentation on systems and procedures normally required for recordkeeping and control purposes. Likewise, USAID regulations (MOM, Receipt Control and Program Final Use and Project Personal Property) requires that donors maintain the necessary documentation to support the disposal of all equipment and goods financed by USAID.

Cause:

The lack of sufficient financial and human resources has prevented FENADESAL from taking the appropriate actions with respect to the current situation, along with the fact that the ability to obtain and hire the necessary resources is subject to CEPA's approval.

Effect:

The lack of adequately documented policies and procedures may cause operational activities of the institution to not be carried out based on an adequate administration of the goods, or that the same be carried out in a disorganized manner allowing errors and irregularities to occur and not be detected in a timely manner. Additionally, the observed condition represents noncompliance with the USAID/El Salvador Agreement.

Recommendation:

FENADESAL should obtain from CEPA formally approved procedures adjusted to its operational characteristics, or develop them under its responsibility, an administrative procedures manual that includes inventory administration.

3. Deficiencies were identified in FENADESAL warehouses related to inventory and kardex cards control.

Condition:

The general materials warehouse does not perform physical inventories, as required by the agreement standards. Additionally, the results of the physical inventories are not reconciled with the kardex cards, which, as observed at the time of our review, were being performed with approximately a one month delay.

Criteria:

OMB Circular A-110, Article N, requires that periodic physical inventories be taken and that the results be reconciled with the kardex cards and accounting records, investigating the resulting differences.

Cause:

The lack of sufficient human and financial resources has caused the existing conditions.

Effect:

The delays in the kardex system recording affect the information on the availability of inventory administered by the entity. Additionally, the lack of control over the inventory and kardex systems and the resulting lack of reliability on the system, increases the risk that errors and irregularities may occur not be detected in a timely manner by FENADESAL officials or employees during the normal course of their assigned duties.

Recommendation:

FENADESAL should make the required efforts, including obtaining CEPA's support, to hire consultants that may help them to modernize the application systems, requiring from them the development and implementation of an administrative procedures manual covering all

items corresponding to the inventory area. Within the implementation requirements, priority should be given to training of the staff involved.

- 4. The physical conditions of some warehouses do not offer adequate protection or segregation for the fixed assets purchased under the project.***

Condition:

The lubricant general warehouse does not have an appropriate organization for physical arrangement of the goods. It was also noted that applicable racks or shelves were missing. Furthermore, the assets purchased under the project have not been segregated and identified with the USAID logo or label.

Criteria:

According to standard USAID specifications and the application of sound accounting practices for proper accountability, an strong environment and control system require that the assets purchased be maintained in adequate storage conditions, in warehouses in good physical condition, and handled with appropriate equipment.

In accordance with the general specifications of the project Grant Agreement, attached to the Agreement, section B.8, the recipient must notify the public and the project of the donation, as a program to which the United States has contributed, for which it is necessary to identify and mark the goods financed by USAID.

Cause:

The lack of human and financial resources have caused the existing conditions.

Effect:

Inadequate conditions for storage of the goods increases the risk of loss of the assets and may cause equipment deterioration before its final use. The lack of appropriate equipment in the warehouses is causing overcrowding of goods in some warehouses, making it difficult to locate and control them.

Recommendation:

FENADESAL should make the required investments to put the warehouses in adequate conditions for appropriate storage and handling of Project goods, requesting for that purpose and, urgently, CEPA's support. Likewise, it should comply immediately with the requirements in the USAID Grant Agreement in the sense of physically identifying all assets purchased with funds under the project.

- 5. *Some of the project reports and fixed asset inventory listings for assets purchased under the project are improvised and are not reliable.***

Condition:

Conditions noted were as follows:

- The goods acquired and paid for directly by USAID/El Salvador have not been accounted for, as well as the computer equipment transferred by CEPA to FENADESAL.
- The Roads and Structures Department Warehouse performs accounting using only certain control ledgers, improvised and unreliable to determine and reconcile physical inventory balances.
- There is no physical separation between Project goods and others, or complete identification among them.

Criteria:

Letter of Implementation 60, as Appendix 2 to the Grant Agreement, Article B, Section B.5, required the maintenance of adequate accounting records. Letter of Implementation 3, sections VI.B.1 and VI.B.2 established that the Government of El Salvador (GOES) would ensure that adequate accounting records would be maintained for Project operations.

Cause:

The lack of financial resources has not allowed FENADESAL to modernize the current systems and procedures.

Effect:

FENADESAL does not have complete and timely accounting information for all warehouses as to materials financed with USAID funds. Nor is there certainty that the reports on inventory balances are updated and include the most recent transactions. This situation affects the planning for purchases and may result in unnecessary disbursements.

Recommendation:

FENADESAL should design and implement an adequate system to account for project transactions and at the same time require SETEFE's approval for its incorporation or implementation in practice. Likewise, it should make all necessary efforts to design appropriate administrative procedures for the receipt of goods, the updating of kardex cards and the taking of inventory, ensuring at all times compliance with the conditions of the USAID Grant Agreement.

- 6. *FENADESAL does not have adequate insurance coverage on the warehouses and their contents.***

Condition:

There is no adequate insurance coverage on the warehouses and their contents.

Criteria:

A strong internal control structure to safeguard the assets, requires the maintenance of insurance in case of disasters that could take place. Furthermore, the general requirements of the Agreement, Section C.7 (b), Insurance, require that the donor insure the goods financed under the project against the risk of loss from the moment of their receipt up to the point of final use.

Cause:

Lack of sufficient financial resources and the lack of acknowledgment of the importance of purchasing insurance or the adoption of other precaution alternatives on the part of FENADESAL management caused the existing conditions.

Effect:

The lack of adequate insurance coverage for assets acquired under the Project may cause significant losses in case of disaster, which might in turn adversely affect project execution and the achievement of the established goals.

Recommendation:

FENADESAL should make the budgetary allocations required to purchase the insurance that adequately covers, at a minimum, the project assets purchased with funds under the USAID Grant Agreement.

III. Commodity Management System Compliance with Agreement Terms and Applicable Laws and Regulations

A. Independent Consultant's Report on Compliance with Agreement Terms and Applicable Laws and Regulations

We have applied procedures to test the Lempa River Hydroelectric Executive Commission's (FENADESAL) compliance with requirements governing the Commodity Management System that are applicable to the Public Services Improvement Project (PSIP), USAID/El Salvador Project No. 519-0320.

We conducted our review in accordance with generally accepted auditing standards and the Government Auditing Standards issued by the Comptroller General of the United States.

Compliance with laws, regulations, contracts and grants applicable to FENADESAL and the PSIP project is the responsibility of that entity's management. As part of obtaining reasonable assurance about the compliance of the commodity management system, we performed tests of the FENADESAL's compliance with the grant agreement for the PSIP project and its amendments, and the Project Grant Standard Provisions.

Material instances of noncompliance 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 commodity management system. The results of our tests of compliance disclosed the following instance of noncompliance that is described as finding number 3 in Section II of the report and is summarized as:

4. Fixed assets or goods which have not been identified by the USAID logo or label.
5. Goods acquired and paid directly by USAID/El Salvador which have not been completely accounted for.
6. FENADESAL does not have adequate insurance coverage on the warehouses and their contents.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, FENADESAL complied, in all material respects, with the provisions

referred to in the third paragraph of this report, and that with respect to the items not tested, nothing came to our attention that caused us to believe that FENADESAL had not complied, in all material respects, with those provisions.

This report is intended for the information of FENADESAL and the U.S. Agency for International Development.

Price Waterhouse

January 14, 1994
San Salvador

IV. Status of Prior Review Recommendations for the Commodity Management System

As a component of the SABM review of FENADESAL, we reviewed the status of recommendations made during previous audits and consulting engagements to determine which ones had not been implemented to date. FENADESAL's SABM has been subject to two reviews during the Public Services Improvement Project:

- Louis Berger International, Inc. (September 30, 1992)
- Arthur Andersen (June 3, 1992)

Our review revealed that FENADESAL has made significant efforts to implement the recommendations previously made. However, its very limited financial situation and its dependence on CEPA are factors that, among others, have not allowed it to date to incorporate all applicable recommendations.

This section describes the prior review recommendations and our observation at the time of our evaluation of those situations that, in our judgment, have not been resolved. We make reference to the corresponding number of the recommendation in the original report and also to the finding in this report that includes this information.

A. Louis Berger International, Inc. (September 30, 1992)

- *Recommendation:* A "Procedures for the Operation of Warehouses Manual" should be prepared and distributed among all institutions to ensure standardized procedures, improve control of the materials and increase operational efficiency.

PW Comment: Recommendation included in Observation No. 2 of the Internal Control Structure in this report.

- *Recommendation:* Increase the existing space in the warehouses so that materials in them may be duly stored.

PW Comment: Recommendation included in Observation No. 3 of the Internal Control Structure in this report.

- **Recommendation:** Assign additional staff to the warehouse (laborers) to maintain the warehouse clean and tidy. Also, to assist in properly storing the material, marking it to identify it correctly, etc..

PW Comment: Recommendation included in Observation No. 1 of the Internal Control Structure in this Report.

- **Recommendation:** Install a computer in linked line with CEPA Central Systems so that all warehouse data may be transmitted quickly.

PW Comment: Recommendation included in Observation No. 4 of the Internal Control Structure in this Report.

- **Recommendation:** An audit should be carried out on the existing materials in warehouses to identify obsolete materials or materials in excess of current needs. All obsolete or excess materials should be removed from the warehouse to provide necessary additional space for active articles.

PW Comment: Recommendation included in Observation No. 3 of the Internal Control Structure in this Report.

B. Arthur Andersen (June 3, 1992)

We do not find recommendations from this evaluation that remained pending for implementation.

APPENDIX I

DESCRIPTION OF THE COMMODITY MANAGEMENT SYSTEM

A. FOREIGN PROCUREMENT

The technical personnel of FENADESAL determine the procurement needs of the entity in relation to the project. The project coordinator submits a listing of these needs to USAID for approval and its incorporation into the procurement plan.

An Invitation for Bid (IFB) is drafted and is submitted to USAID for their approval. USAID approves the IFB via a Letter of Implementation (PIL).

The solicitation is published in the "Commerce Business Daily" (CBD) and in local newspapers. The IFB's are distributed to those interested in participating.

Offeror bids are collected until the established date and time. Offerors are registered according to the names of the suppliers, who sign the registry along with a USAID observer. The offers are opened on the date designated by the Evaluation Committee which is composed of members of FENADESAL and a USAID observer.

Comparative charts of the bids are developed. The Evaluation Committee recommends a supplier to whom an award should be made and submits the recommendation to the Award Committee.

The Award Committee is integrated with the Railways Committee of CEPA, who approves the recommendation made by the Evaluation Committee to award the procurement, always in the presence of a USAID representative. The resolution is sent to USAID for their final approval.

USAID approves the award and contract, sends a fax of the award, and issues a commitment letter (L/COM) guaranteeing financing of the purchase of the goods. FENADESAL sends the supplier a fax regarding the award and contract.

The procurement management of CEPA is responsible for coordinating all logistics for importation, clearance through customs and receiving of the goods by FENADESAL's warehouses.

The commodities are received by the warehouse "shop materials" department in the presence of the chief of this department, the warehouseman, the chief of the soliciting department, and an observer from USAID. The commodities are inspected individually and compared against their IFB and importation documentation. A receiving report is prepared (noting any discrepancies if there are any), and the report is signed by all of those present. A copy of the report is sent to USAID. In this same department, an inventory code is assigned to the commodities, noting receipt of the commodities by the shop materials department, and is used as a basis for recording the commodities on the kardex cards.

In case of claims against incorrect or damaged commodities, the claims are directed towards the supplier or the representative and the supplier is held responsible for filing any claims with the insurance company.

B. LOCAL PROCUREMENT WITH EXTRAORDINARY FUNDS (PL-480)

Before the need arises to acquire goods, the soliciting department prepares an internal request for materials and presents it to the "shop materials" department.

The "shop materials" department prepares a purchase/service order and sends it to the CEPA procurement department for authorization from the management of FENADESAL.

The CEPA procurement department prepares a request for bid from suppliers, reviews and makes a public announcement, private or public, or for free competition according to the total amount of the goods to be purchased. The terms of reference are sent to the suppliers interested in participating.

Even when, due to its amount it should be a free competition, it is policy for FENADESAL to request at least three of the registered suppliers to submit their bids.

The CEPA procurement department receives and records the bids and prepares evaluation charts and supply orders. Depending on the amount of the procurement, the Chief of Procurement awards or submits the award decision and procurement to the CEPA Board of Directors. A purchase order is prepared and delivered to the supplier.

The supplier delivers the goods to the shop materials department. All of the goods and parts are checked individually. If no discrepancies exist, the receiving report is signed. On the contrary, if discrepancies do exist then the receiving report is not signed until the situation is resolved. The goods are coded and the warehouse receiving document is prepared. Afterwards, the person in charge of the revolving fund submits payment for the goods.

C. MOVEMENT BETWEEN WAREHOUSES AND END USE OF MATERIALS

The need to utilize goods exists. The soliciting department (of Equipment or Roads and Structures) submits a request for materials.

The chief of the shop materials department authorizes the distribution of the goods and the warehouseman delivers the goods (previously coded) and signs the receipt voucher, based on the deletion of the goods from the kardex cards.

Upon completing a work order, whether it is for the repair of equipment or improvement of a road, bridge or sewer the department responsible for the completed work examines the "condition" of the completed work, verifying the final use of the parts and goods and declares it received.

D. TRANSFERRING OF COMMODITIES AMONG WAREHOUSES

When parts and goods are transferred among warehouses, the department of Equipment or the department of Roads and Structures may intervene. At the warehouse of the first department the warehouseman does not document the distribution of materials for their end use, since it cannot determine its physical existence. In the Roads and Structures Warehouse a book logging entrance and exit of goods is used, but is not dependable. It appears that the warehouseman does not have an understanding of the procedures that should be followed for the registration of the movement of inventory.

APPENDIX II

LIST OF WAREHOUSES VISITED

1. General Warehouse for Materials, which also includes the Warehouse of Lubricants and the Spare Parts Warehouse.
2. Warehouse of the Department of Equipment
3. Warehouse of the Department of Roads and Structures

APPENDIX III

LIST OF PERSONS INTERVIEWED

<u>Office</u>	<u>Name</u>	<u>Position</u>
FENADESAL	Ing. Tulio Omar Vergara	Manager
FENADESAL	Ing. Julio Pineda	Chief of Dept. of Equipment
FENADESAL	Ing. Abelino Cruz	Chief of Dept. of Roads and Structures
FENADESAL	Lic. Luis Guzmán	Chief of Warehouse of Materials
FENADESAL	Lic. Fredy Mayora	Chief of Finance
FENADESAL	Lic. Jerónimo Varela	In Charge of Revolving Fund
FENADESAL	Sta. Norma Martínez	Project Accountant
FENADESAL	Sr. Hernán Marinero	General Warehouseman
FENADESAL	Sr. Elidir Salgado	Warehouseman E.5 (Roads and Structures)
FENADESAL	Sr. Jeremías Durán	Lubricants Warehouseman
PROCUREMENT/CEPA	Ing. José G. Merlos	Chief of Procurement
AUDITOR/CEPA	Lic. Larios	Internal Auditor
USAID	José Miguel Campos	Commodities Specialist
USAID	Javier Houdelot	Project Officer, FENADESAL

APPENDIX IV

LIST OF DOCUMENTS REVIEWED AND REFERENCED

- Grant Agreement
- Action Plan (May 1992 - December 1992)
- Project Paper for the Public Services Improvement Project
- A.I.D. HANDBOOK 1
- A.I.D. HANDBOOK 10
- A.I.D. HANDBOOK 11, Host Country Contracting
- A.I.D. HANDBOOK 14, FAR Regulations
- A.I.D. HANDBOOK 15, A.I.D. Financed Commodities
- OMB CIRCULARS A-110, A-123 and A-125
- PIL Nos. 3, 10, 54, 57, 60, 70, 71, and 77
- Host Country Contracting Assessment
- Auditor Reports:
 1. Arthur Andersen & Co. (June 3, 1992): Awards Study of Project No. 519-0320.
 2. Louis Berger International, Inc. (September 30, 1992): Verification of Inventory.
 3. Ing. Roger Valle (October 25, 1993): DEVRES Recommendations.
 4. López Salgado and Co. (July 23, 1992): Financial audit of the projects financed with funds from the local currency program within the PERE through December 31, 1991.
 5. Esquivel and Associates: External auditor reports for the following periods: December 31, 1990; June 30, and December 31, 1991; June 30, 1993.
 6. Esquivel and Associates: Report of recommendations on the internal control system and other accounting matters through June 30, 1990.

Documents from FENADESAL:

- Inventory Control System prepared by the CEPA Department of Information Systems.
- Users Manual for the Inventory Control System.
- Description of project personnel posts at FENADESAL.

APPENDIX V

VISITS OVER FINAL USE

Except for the reported conditions described in this report, resulting from our visits to selected warehouses and our inspection of project commodities, nothing came to our attention that would indicate the existence of other inadequacies or weaknesses over the final use of commodities.

COMENTARIOS DE LA ADMINISTRACION DE FENADESAL AL BORRADOR DEL DOCUMENTO "REVISION DEL SISTEMA DE ADMINISTRACION DE BIENES MUEBLES DE FENADESAL"

1) Estructura de Control Interno del Sistema de Administración de Bienes Muebles.

Observación:

1.1) FENADESAL no cuenta con una adecuada definición y asignación de las responsabilidades por la custodia de los bienes, además de que se observa una insuficiente segregación de funciones

Condición observada:

La responsabilidad por la custodia de los bienes no está adecuadamente definida y segregada, puesto que la recepción de materiales la firma el jefe del departamento, no obstante que es el bodeguero sobre quien recae la responsabilidad del control de las existencias. Además, no existe un documento que describa el sistema de administración de inventarios para conocimiento del personal relacionado con los mismos.

Comentario de FENADESAL:

Actualmente la responsabilidad por la custodia de los bienes recae en su totalidad en el Jefe de Almacenes y Materiales, siendo responsable desde la recepción de los bienes hasta la autorización de despacho de los mismos, que son solicitados por medio de requisiciones. Con respecto a la no existencia de un documento que describa el sistema de administración de inventarios, FENADESAL está implementando la mecanización del control del inventario, por lo que posee un documento en este aspecto.

Observación:

1.2) FENADESAL no cuenta con un documento debidamente aprobado por USAID/EL SALVADOR sobre el sistema de administración de inventarios.

Condición observada:

No existe un documento debidamente aprobado por USAID/El Salvador y que describa integralmente el sistema de administración de inventarios, para conocimiento del personal relacionado con los mismos y su aplicación en la práctica.

Comentario de FENADESAL:

CEPA/FENADESAL ya ha desarrollado un documento respecto a la mecanización del control y administración de inventarios de FENADESAL, que fue presentado al Sr. Valle de la firma Louis Berger Consultores para sus comentarios, sin que hasta la fecha hayamos recibido respuesta, además, CEPA/FENADESAL está en proceso de contratación de dos analistas de sistemas para mejorar el sistema mecanizado de administración de inventarios.

Observación:

- 1.3) Las bodegas de FENADESAL demostraron deficiencias en las áreas de control de inventario y de tarjetas Kardex.

Condición observada:

El almacén general de materiales no practica los chequeos de inventario físico recomendados por las normas del convenio. Adicionalmente, los resultados de los inventarios físicos practicados no se concilian con las tarjetas Kardex, las cuales se observó a la fecha de nuestra revisión se operaban con aproximadamente un mes de atraso.

Comentario de FENADESAL:

Actualmente se están realizando todos los esfuerzos para conciliar el inventario físico con las tarjetas kardex de los bienes adquiridos con el financiamiento de AID, al mismo tiempo se está realizando una capacitación del personal involucrado en la administración de inventarios.

Observación:

- 1.4) Las condiciones físicas de las bodegas no ofrecen la protección o segregación adecuada a los bienes muebles adquiridos bajo el proyecto.

Condición observada:

El almacén general de lubricantes no cuenta con la apropiada organización sobre el ordenamiento físico de los bienes. También se observó que faltan estanterías y anaqueles apropiados. Además, los bienes adquiridos por el proyecto no han sido segregados e identificados con el marbete o logo de USAID.

Comentario de FENADESAL:

La observación se refiere específicamente a la bodega de "Lubricantes" que también almacena las pinturas

utilizadas en el proyecto, situación que ya se subsana segregando adecuadamente los bienes adquiridos mediante el proyecto, además hemos procedido a marcar con las siglas AID todas las estanterías que almacenan los bienes correspondientes.

Observación:

- 1.5) Los informes y reportes del proyecto sobre las existencias de los bienes muebles adquiridos bajo el proyecto son improvisados y no resultan confiables.

Condición observada:

Las condiciones reportables notadas fueron:

- Los bienes adquiridos y pagados directamente por USAID/El Salvador no han sido contabilizados, al igual que el equipo de cómputo transferido por CEPA a FENADESAL.
- El Almacén del Departamento de Vías y Estructuras cuenta solamente con ciertos libros de control improvisados y no confiables para determinar y conciliar los saldos físicos de los bienes en existencia.
- No existe separación entre los bienes del proyecto y otros, o una plena identificación entre ellos.

Comentario de FENADESAL:

Todos los bienes adquiridos bajo el proyecto son contabilizados y controlados oportunamente en el sistema de FENADESAL, con la excepción del equipo de computación que ha sido administrado por el departamento de Sistema de Información de CEPA, sin que hasta el momento nos haya proporcionado la documentación necesaria, por lo que ya procedimos a solicitarla para poder registrarlos en nuestro sistema. Con respecto a los denominados Almacenes del Departamento de Vías y Estructuras y del Departamento de Equipos, estos contienen solamente bienes en proceso de instalación y utilización, por lo que ya se ha determinado su uso final específico consecuentemente, su existencia ya está registrada al salir del Almacén de FENADESAL.

Otra observación consiste en que no existe una plena identificación de los bienes adquiridos por el proyecto. Los bienes se identifican mediante una "Tarjeta de Registro", que identifica a cada uno de los bienes conteniendo toda la información necesaria para poder establecer su origen, por lo tanto están identificados los bienes adquiridos bajo el proyecto.

Otra consideración conveniente es que FENADESAL está en proceso de implementación del sistema de "Contabilidad Gubernamental" que incluye la Administración de Inventarios, por lo que se está contratando a dos firmas que desarrollarán todos los procedimientos necesarios para ello.

Observación:

- 1.6) FENADESAL no cuenta con una adecuada cobertura de seguros sobre los almacenes y su contenido.

Condición observada:

No existe una adecuada cobertura de seguros sobre los almacenes y sus contenidos.

Comentario de FENADESAL:

FENADESAL, al ser una empresa subsidiada, no posee los recursos necesarios para cubrir las altas primas de los seguros, por lo que solamente tiene aseguradas sus edificaciones fijas tales como: estaciones, talleres, bodegas de mercaderías en tránsito y muelle de Cutuco, excluyendo de asegurar a toda su infraestructura y equipo de operación, por ser demasiado oneroso el pago para ello, a pesar de estar plenamente convencida de la importancia de la cobertura de sus bienes, contra cualquier siniestro. Considerando lo anterior, haremos todas las gestiones necesarias para poder incluir al menos los bienes adquiridos bajo el proyecto, en el seguro de FENADESAL.