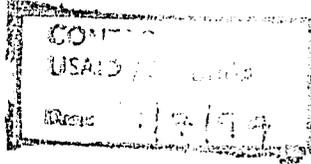


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PN-ABR-161



**UNITED STATES AGENCY FOR
INTERNATIONAL DEVELOPMENT
MISSION TO SRI LANKA**

***ASSESSMENT OF FINANCIAL
MANAGEMENT SYSTEMS OF HOST
COUNTRY IMPLEMENTING
AGENCIES***

CONTRACT NO : 383-0499-C-00-3453-00
DELIVERY ORDER NO : 383-0499-C-01-3453-00

INSTITUTE OF FUNDAMENTAL STUDIES

December 1993

**Coopers
& Lybrand**

Our reference PDR/338/93

30 December 1993

117/93

Ms Linda Tarpeh-Doe
Financial Controller
United States Agency for International Development
356 Galle Road
Colombo 3.

Dear Madam

Indefinite Quantity : 383 - 0499 - C - 00- 3457-00
Delivery Order No : 383 - 0499 - C - 01- 3457-00
Institute of Fundamental Studies (IFS)

1 In accordance with the instructions given and terms of reference set out in Article IV of the above Delivery Order, we are pleased to present our report on the Assessment of the Financial Management System of IFS. The detailed report was discussed with Mr P L R Alwis, Accountant, and his observations and suggestions have been incorporated in the draft report.

2 Our findings, comments and recommendations were given in eight chapters, one chapter being devoted to each work task defined in the terms of reference.

3 The more important comments and findings are given below as an executive summary.

The Institute and Organisation Structure

4 The Institute was established under an Act of Parliament.

5 The organisation structure of the Institute broadly consists of the Academic and Non-Academic Divisions.

6 The goals, organisation structure and the roles of office holders, the powers and privileges of officials of the Institute, its functions and responsibilities, reporting and monitoring procedures are all laid down in the Act of Parliament under which IFS was established.

1

Finance Division and Span of Control

7 The Accountant, in addition to being in charge of the Finance Department, also holds the post of Administration Officer.

8 This has, in our opinion, resulted in too wide a span of control for efficient functioning. We were assured, that this issue would be resolved with the restructuring of the Accounts Unit.

Administrative and Management Capability

9 The Institute ensures competence of its academic staff by strictly following the requirement that only those with atleast a basic science degree of a recognised university are recruited.

10 As stated in detail in Chapter 2, there is no reason to doubt the competence of the staff of the non-academic Division.

Internal Control

11 Chapters 3 and 4 describe the control procedures in operation and our recommendations to improve the existing system. The purchase/ payment procedure is documented in the form of flow charts which are given as exhibits to Chapter 3. The more important internal control issues can be summarised as follows:

<u>Paragraph Reference</u>	<u>Description</u>
3.6	Risk of committing funds in excess of the approved budget, because the votes ledger is updated only after the delivery of goods. Recommendations to overcome this risk are made in paragraph 3.7
3.9	The risk of duplicate payments being made erroneously or fraudulently as documents supporting payments are not effectively cancelled. This risk is greater when goods are received in instalments. Effective cancellation procedures recommended in paragraph 3.10
3.13	An effective control procedure could be established over the validity of payroll costs by implementing the recommendations made in paragraphs 3.14 and 3.15.

- 3.20 Specialised work of a technical nature relating to a specific department is sometimes carried out by hired staff. The recommendation to entrust such work to hired staff, evaluate the work done and approve payment are carried out by the relevant departmental head. The absence of a division of duties enables one person to make or process invalid payments.
- 4.3 We have recommended segregation of duties between those handling cash and those approving payment related documents, in order to avoid fraud.
- 4.7 Obtaining "hand" quotations for purchases of less than Rs 3,000 and the subsequent payment and collection of goods by the same person is regarded as concentration of incompatible duties in the hands of one person.
- 4.11 Recommendations to overcome certain difficulties that arise from over and under budgeting are given in paragraph 4.11.

Value for Money Reviews

12 As explained in paragraph 4.12, it is necessary to ensure that in the accomplishment of the objectives of the Institute there is economy in the commitment of funds and effective carrying out of operations.

13 Accordingly, we suggest that IFS develop a series of performance and cost indicators to guide and monitor its operations, control costs and measure output of performance against set targets.

Contract management capability and tender procedure

14 Contracts for services, supply of materials, capital projects, tender procedures, criteria for selection of suppliers etc. are dealt with in Chapter 5.

We have made the following recommendations:

- c IFS should establish procedures to register suppliers and agree prices periodically.

0

- o Goods ordered and received, subsequent to the evaluation of a tender, should be compared with the criteria on which the supplier was selected to ensure that such criteria are in fact adhered to.

Control over commodities

15 Our findings and recommendations are given in Chapter 6 and are summarised below:

- o Laboratory issues are overstated as a result of not clearly understanding the basis of absorbing certain overheads relating to stock holding.
- o Controls in respect of the issue and receipt of Departmental Requisition Notes (DRNs) are to be strengthened as described in paragraphs 6.8 and 6.9, to ensure that all DRNs are input for computer processing.
- o The difficulty of relating a specific Goods Receipt Note (GRN) to a bincard or the stores ledger could be overcome by entering GRN reference numbers in a separate column in the bincards and stores ledger.
- o The effectiveness of controls provided by the Fixed Assets Register (FAR) could be enhanced by providing additional information as described in paragraph 6.17.
- o Procedures must be established to record the transfer of fixed assets.
- o All fixed assets received as grants in kind must be accurately accounted for, and the FAR should be updated at all times.
- o Gate Passes must always be filed in serial sequence.

General

16 If you require any further information or clarification, please contact the engagement partner Mr P D Rodrigo, or the Manager Mr Sanjay Niles.

Yours truly

Amrinder Singh

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CHAPTER 1

TASK (A)

"REVIEW & COMMENT ON THE LEGAL STATUS, GOALS, ORGANISATION STRUCTURE, STRUCTURE OF THE FINANCE DIVISION AND SOURCES OF FUNDING"

Legal status

- 1.1 The Institute of Fundamental Studies (IFS) Sri Lanka is established under an Act of Parliament of the Democratic Socialist Republic of Sri Lanka, Act No 55 of 1981. It is constituted as a statutory Board.

Objectives

- 1.2 The aims and objectives of the Institute are to create an interest in and to provide facilities for fundamental and advanced studies and in particular to:
- o initiate, promote and conduct research and original investigations in fundamental studies in general and with particular emphasis on Mathematics, Physics, Chemistry, Life Sciences, Social Sciences and Philosophy;
 - o arrange lectures, meetings, seminars and symposia in pursuance of its academic work and for the diffusion of scientific knowledge;
 - o invite scientists, in Sri Lanka and from abroad, actively engaged in creative work to deliver lectures and participate in its academic activities;

- o establish and maintain liaison with scientific workers and scientific institutions in other countries and promote international co-operation in matters relating to the aims and objectives of the Institute;
- o do such other acts and things as may be necessary to promote the aims and objects of the Institute.

Organisation structure

1.3 The organisation structure is defined by the Act incorporating the Institute. The key positions, the functions of the personnel occupying such positions and the appointment criteria are also defined by this Act.

1.4 The organisation structure of the Institute is given as Appendix A to this chapter.

1.5 The Institute is headed by a Board of Governors. The President of the Democratic Socialist Republic of Sri Lanka is also the Chairman of the Board of Governors. Other members of the Board include :

- o the Prime Minister;
- o the Leader of the Opposition;
- o The Minister of Industries, Science and Technology
- o The Minister of Justice and Higher Education
- o The Chairman, University Grants Commission
- o The Director of the Institute

- o three persons elected from among its members by the Academic Council, each of whom shall hold office for three years or until he ceases to be a member of the Academic Council, whichever date is earlier; and
- o four other persons appointed by His Excellency the President of the Democratic Socialist Republic of Sri Lanka for a period of three years from among persons who in his opinion are specially qualified in relation to the work of the Institute.
- o The Secretary to the Board, who is also appointed by His Excellency the President

The board meets once a quarter at the Presidential Secretariat

1.6 The operations of the Institute are carried out under separate division: as follows:

- (a) Academic division
- (b) Non Academic divisions.

1.7 The Academic division is headed by the Academic Council. The Academic Council is headed by the Director of the Institute (ex officio) who functions as the Chairman of the Council. The other members of the Academic Council are as follows:

- o the Associate Directors and Deputy Directors where so appointed (ex officio);
- o the permanent professors of the Institute;
- o the permanent members of the Institute;
- o two members elected from among their members by the research fellows of the Institute; and

- o not more than two representatives of each of the Universities in Sri Lanka nominated by the Board, (usually the Vice Chancellors and Deans of the Science/Engineering faculties are appointed).

Non academic division

- 1.8 All activities of the non academic division of the Institute is headed by the Secretary to the Institute, who is also (ex-officio) Secretary to the Board.
- 1.9 However the "Manual of Procedures" developed by IFS, in the interpreting of the Act, categorically spells out that the Director of the Institute shall have the ruling power in any matter be it academic or administrative.
- 1.10 All reporting on the affairs of the Institute is carried out under the purview of the Director to the Institute. However, the Secretary to the Board who is also (ex-officio) Secretary to the Institute has the implied power to make an independent enquiry, assessment and representation to the Board, on any contiguous matter, if specifically requested to do so, by the Board.
- 1.11 Clarifications and ruling on any issue what-so-ever are handled directly by the Director. He has the ultimate ruling on any issue pertaining to the Institute.

Finance division

- 1.12 The finance and administration functions fall under the supervision of the Secretary to the Institute who is also Secretary to the Board of Governors. The Finance Department is headed by the Accountant. The Administration Department is headed by the Administration officer. Since November 1991

the post of Administration officer had been vacant. As a result the Accountant, at present, heads both departments.

Span of control

- 1.13 Since the Accountant under the direct supervision of the Secretary now heads both the Finance and Administration Departments, he presently has to supervise the work of fourteen personnel. A span of control beyond five is considered excessive and ineffective. Further, several unrelated activities are also directly supervised by him. As a result the Accountant may at times find it difficult to give all tasks entrusted to him, the due and necessary care.
- 1.14 The position will improve substantially if the administration function is, as required, entrusted to an Administration Officer.
- 1.15 We have been informed that the Institute is presently considering a change of structure of the Finance and Administration Department. The new structure would include the appointment of an Assistant Accountant. It is envisaged that this would allow the Accountant to undertake more managerial functions, since the Assistant Accountant would carry out the routine functions of the accounts and Administration department.

Accounts unit

- 1.16 The structure of the Accounts unit (Finance Department) is given as Appendix B to this chapter.
- 1.17 Although the structure of the unit indicates that the senior Accounts assistant is the head of this unit, this structure is not adhered to in practice since her main task is to

maintain the Institute's Books of Account. This has resulted in a large amount of work being done directly by the Accountant and the clerical staff. The issue in hand would be resolved by the restructuring of the Accounts unit.

1.18 The Act of Parliament No 55 of 1981 under which the Institute is set-up, provides for annual grants from the Government of Sri Lanka for the purpose of carrying out the aims and objectives of the Institute.

1.19 The Institute is entitled to receive grants from any source, whether in Sri Lanka or abroad, and to negotiate directly for such grants with any individual, Institution or body of persons whether incorporate or not, for the purpose of carrying out its aims and objectives.

1.20 Accordingly, the Institute has negotiated with several foreign donors to receive assistance for its various programmes and activities. The donors, who have in the past provided funds are as follows:

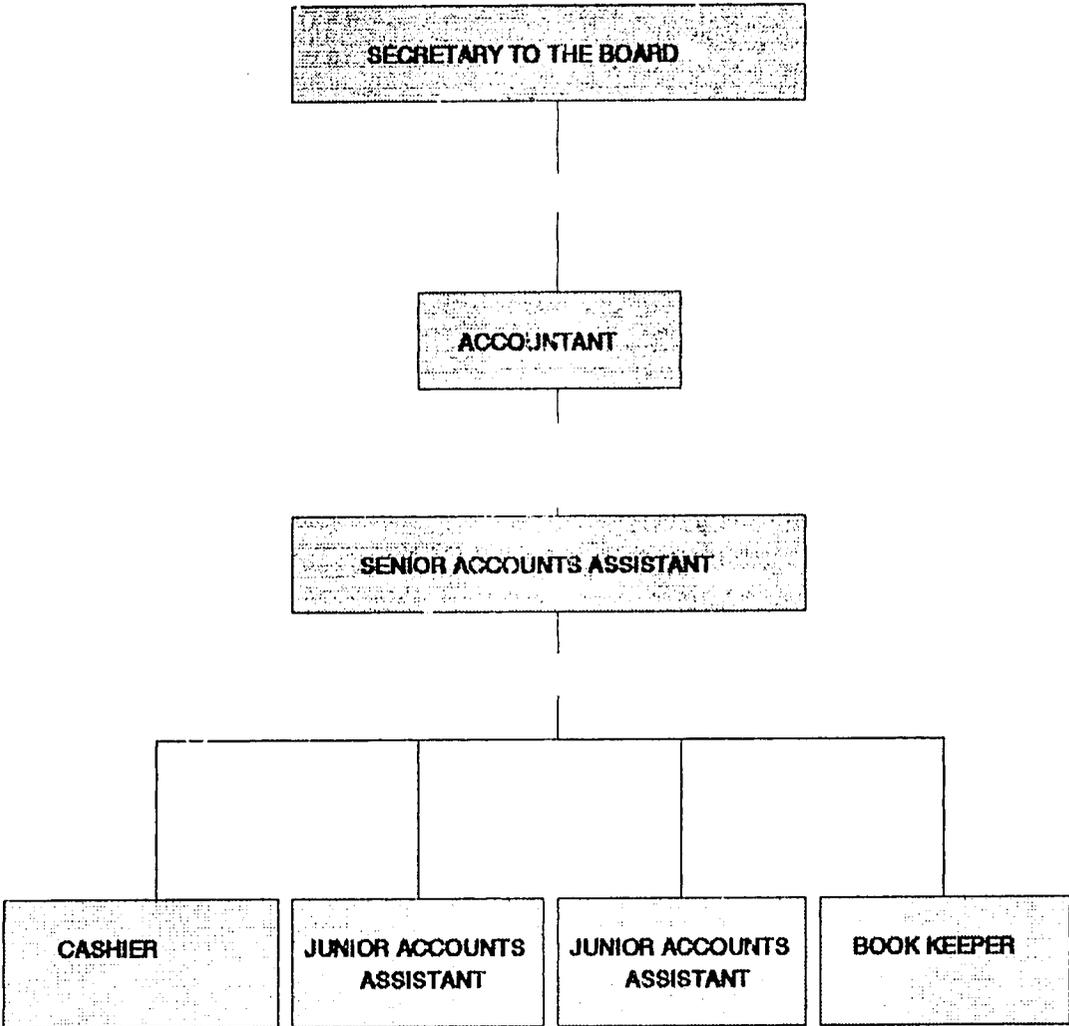
- o Belgium Administration for Development Co-operation (BADC)
- o The Canada Fund Programme of the Canadian High Commission in Sri Lanka.
- o The Catholic University of Leuven, Belgium
- o The Forest Department of Sri Lanka
- o The International Atomic Energy Agency (IAEA)
- o The International Development Research Centre Canada (IDRC)
- o The International Foundation for Science, Sweden

- o The Laboratory for Chemical Evolution of the University of Maryland, USA;
- o The Ministry of Environmental and Parliamentary Affairs Sri Lanka;
- o The National Aquatic Resources Agency (NARA)
- o The National Resources, Energy and Science Authority of Sri Lanka (NARESA);
- o The Norwegian Agency for Development Cooperation of the Royal Norwegian Embassy in Sri Lanka (NORAD);
- o The Palmyrah Development Board of Sri Lanka;
- o The State Gem Corporation, Sri Lanka;
- o The Third World Academy of Science (TWAS);
- o The United Nations Educational Scientific and Cultural Organisation (UNESCO);
- o The United States Agency for International Development (USAID);
- o The Uva Provincial Council, Sri Lanka;
- o United Nations Development Programme (UNDP)
- o 'Vidyasilpa' Sri Lanka;
- o The World Health Organisation (WHO).

1.21 Additionally the Government of Japan has donated equipment for the laboratories.

1.22 Fund accounting is done as per the specifications of donor agencies.

STRUCTURE OF THE ACCOUNTS UNIT



CHAPTER 2

TASK - (B)

"REVIEW AND COMMENT ON THE ADMINISTRATIVE AND MANAGEMENT CAPABILITY OF THE ORGANISATION. THE ADMINISTRATIVE AND MANAGEMENT CAPABILITY OF THE FINANCE DIVISION SHOULD ALSO BE ADDRESSED WITH PARTICULAR EMPHASIS ON THE MANAGEMENT OF THE AID PROJECT"

Organisation

2.1 IFS has the following five principal academic departments:

- o Earth and Space Sciences
- o Life Sciences
- o Environmental Sciences
- o Philosophy and Social Sciences
- o Physical and Chemical Sciences

2.2 Mathematics and Computer Sciences are not presently considered to be a priority and therefore function as mere support activities for the five principal departments.

2.3 The Academic staff of each department is headed by a holder of a Phd from one of the recognised Universities. Each department has members and research fellows in addition to the head of the department.

2.4 In keeping with the nature of operations of the Institution, all staff are academically qualified. All research assistants possess

at least a basic science degree from a University in Sri Lanka. All research fellows are Phd holders.

2.5 The academic staff is also responsible for writing research proposals and winning funds from grantors and donor agencies. Donors evaluate the technical competence of the staff before granting funds. Further, the research findings are published in overseas science magazines and journals of repute. A copy of the Annual Review which summarises the research findings, is sent to the donors at their requests. For the purpose of our work we consider the procedure followed, adequate to assess the capabilities of the academic staff.

2.6 The Secretary to the Institute who is also (ex-officio) the Secretary to the Board is a Senior Civil Servant with over 35 years of experience in the civil service and state enterprises. The Accountant has passed all examinations of the Chartered Institute of Management Accountants and possesses 14 years post qualification experience. These qualifications and experience meet the requirements of the top two positions in the organisation.

2.7 At the interviews we had with these officials it was revealed that a proper system of internal control did not exist in the past and that these had to be built up subsequent to the appointment of the present Secretary and Accountant. Some of the procedures introduced are as follows:

- o Appointment of Internal Auditors
- o Setting up of accounting systems
- o Control over disbursement of cash
- o Inventory control procedures
- o Control over fixed assets

- o System of recruitment
- o Establishment of a Tender Board
- o Introduction of vouchers
- o Introduction of books of account
- o Year-end physical verification of fixed assets

2.8 In carrying out our review we conducted interviews with the Director, Accountant, Secretary and three Heads of Departments with particular emphasis on the administration and management functions. The details of areas covered are given as appendix A to this chapter.

2.9 The answers and comments received at these interviews did not indicate organisational structure weaknesses or other situations that could adversely affect the administrative and management capability of the Institute.

Areas covered in interviews with key officials

- o Suitability of the organisation structure and executive responsibilities.
- o Definition of key areas of control
- o The degree of feedback and managerial response to same
- o Managerial judgement exercised in effective decision making.
- o Integrity, relevance and adequacy of information flows
- o Appointment and resignation of key officials
- o Salary and remuneration scales and determining of these scales
- o Intentional misstatement of financial statements
- o Past incidents of callous fund management, fraud and subsequent legal actions

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Appendix A to chapter 2

- o Levels of staff turnover
- o Disputes and confrontation within and between departments
- o Relationships between employees and outsiders
- o Achievement of budgetary controls and targets / estimates
- o Knowledge and experience of subordinates
- o Planning and monitoring of performance
- o Motivational tools
- o Effectiveness of budgets
- o Crisis management
- o Use of bench marks (if any)

- o Personnel management policies, disciplinary actions taken and accessibility of hierarchy to subordinates
- o Standards and procedures governing the overall control of the activities of the enterprise
- o Levels of independence experienced especially in the case of decision making by the hierarchy
- o Maintenance of facilities and equipment
- o Effectiveness of asset management
- o Growth and social impact of research
- o The Electronic Data Processing (EDP) department, its functions and general impact on the organisation
- o Individual specialised skills in EDP systems
- o User departments' perception of the EDP environment
- o Code of conduct of employees

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Appendix A chapter 2

- o Board meetings, minutes and reporting procedures and adequacy of same.

- o Any other matters of concern and relevance.

CHAPTER 3

TASK - (C)

"REVIEW, DOCUMENT AND COMMENT ON THE ACCOUNTING SYSTEM IN PLACE, ACCOUNTING RECORDS MAINTAINED, INTERNAL CONTROLS AND THE PAYMENT PROCEDURE (FLOW CHARTS MAY BE USED WHEREVER NECESSARY WITH ADEQUATE NARRATIVE EXPLANATION)

IN CONNECTION WITH THE ABOVE ALSO ASSESS THE ADEQUACY OF THE ORGANISATION'S INVOICE EXAMINATION CAPABILITY, PAYMENT PROCEDURES AND INTERNAL CONTROLS IN CONNECTION WITH APPROVAL AND PAYMENT OF INVOICES"

Accounting system

- 3.1 IFS maintains a double entry system of book keeping. The following books of account are kept.
- o Cash books
 - o Journals
 - o Project ledgers
 - o General ledger
- 3.2 A cash book, journal and ledger are maintained for each project. At the end of each month, the project ledgers are summarised and posted to the general ledger. Therefore the project ledger functions as a subsidiary record.
- 3.3 In addition to the above, several subsidiary registers are maintained. These include invoice register, cheques register, and purchase order book.

- 3.4 The internal audit of IFS is carried out by an independent firm of Accountants on a monthly basis. All bank accounts are also reconciled monthly. A statutory audit of IFS is carried out annually by the Auditor General's Departments, the last such audit being done for the year ended 31 December 1992.

Purchase/payment procedure

- 3.5 The purchase/payment procedure is shown in a flow chart form as Appendix A to this chapter. The weaknesses observed by us are documented below. The discussions regarding the segregation of duties is addressed under Task D.

Updating of votes ledger

- 3.6 Departmental Requisition Notes (DRNs) raised by the Department heads are sent to the Accountant to check the availability of votes prior to approval of the purchase. On approval by the Accountant, funds are booked against the relevant vote. However, where the price of an item is not known with certainty, the amount is not booked until the goods are received and the invoiced value is known. As a result, further approvals could inadvertently be given thus committing funds in excess of the budget. This risk will be greater if the time taken to receive the goods and invoice is more than a few weeks.
- 3.7 We recommend that, where prices are not known, an approximate amount be committed in the votes ledger and the final amount be entered once the actual amount is known. This can be done by making a further entry, plus or minus, to the estimated cost booked earlier. Both entries should bear the same reference.
- 3.8 However, it was brought to our attention, that making even an estimated vote for the purchase of certain chemicals would be a difficult task.

Cancellation of documents supporting payment

- 3.9 Supporting documents are not effectively cancelled in all cases with a "PAID" stamp. Thus the documents could be produced again, wilfully to perpetrate fraud or by error to support another payment. This is especially so, in the case of receipt and payment for goods against an order, on a piecemeal basis.
- 3.10 All documents supporting payments must be canceled with a "PAID" stamp which should record the number and date of cheque being issued. For the control to be effective the cheque signatories should ensure that the number and date on the cancelled document correspond with the cheque being signed.

Payroll systems

- 3.11 There are 134 permanent staff on the payroll. They consist of both academic and non-academic (administration) staff. They are recruited as per requirements under the Act and as per specifications laid down at board meetings. Letters of appointment are given to all employees, setting out the basic salaries and other terms of employment. Senior academic staff are appointed under a contract usually for a period of 3 years. All salaries are paid direct to the bank accounts of the employees. Salaries are prepared by the accounts clerk cum cashier with the assistance of the book keeper and are checked and approved by the accountant.
- 3.12 A system similar to that described above, is in operation for payment of wages.

Validity of payroll costs

- 3.13 Payroll costs are greater than any other direct or administration cost. Further there are 134 employees which makes the individual rechecking of entries in the payroll, difficult. Accordingly, a

monthly payroll reconciliation which would give management additional comfort on the validity of payroll costs should be carried out to provide overall assurance that payroll costs do not include salaries for extra names, unauthorised increments and for employees who had left.

- 3.14 A formal payroll reconciliation will entail reconciling the total of basic wages of one month with that of the previous month by accounting for and verifying the movements as follows:

Movement -----	Verification -----
New recruits	Examine copy of letter of appointment
Resignations	Examine memo from the departmental heads confirming resignations. Ensure that all resignations have been removed from the payroll and for this purpose obtain a statement signed by the head of the Personnel Department, of all terminations.
Increments	Check copy of letter of increment and authorisation.

- 3.15 The monthly reconciliation should be reviewed by the Accountant and initialled by him as evidence of having checked the payroll costs for reasonableness and validity of movements.

3.16 The Accountant was of the opinion that the present controls he has established regarding the validity of payroll costs, as detailed below would meet the goals of the above recommendations.

- o Monthly a computer printout of all existing employees is obtained and forwarded to the cashier to prepare the payroll.
- o Once the pay sheets are prepared in the above manner, the Accountant checks all names, salary scales etc. by checking this against data in the master file.
- o All issues and erroneous entries are resolved and rectified instantaneously.

Procurement of services

3.17 When the need for outside repairs and maintenance arises in a specific department/division, the head of that department/division raises a requisition note either using printed forms or by a letter. He intimates his requirements to the Accountant and may even suggest suppliers of his own choice.

3.18 A supplier is selected using the standard quotation procedure, which is explained in detail in task E.

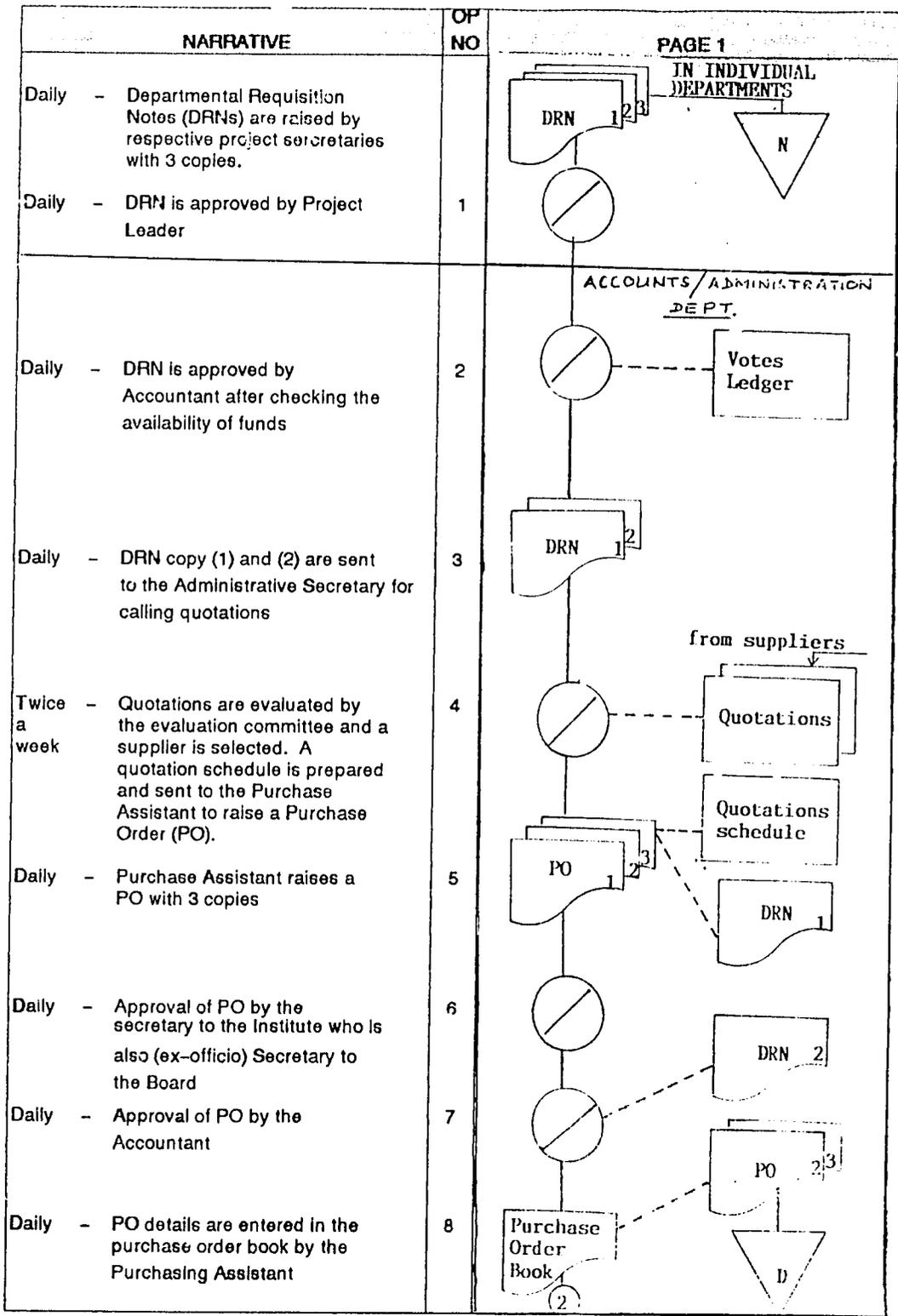
3.19 On completion of the work, the person who requests such services certifies work carried out, by signing the work request form. Thereupon, the payment is made.

3.20 Approval limits for purchases

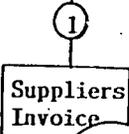
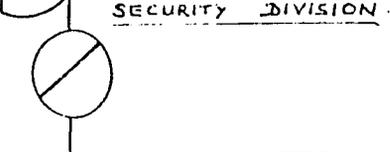
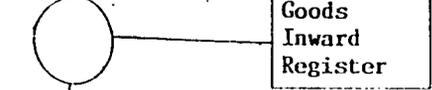
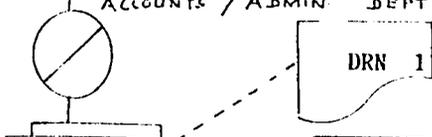
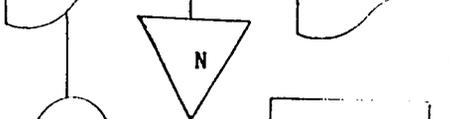
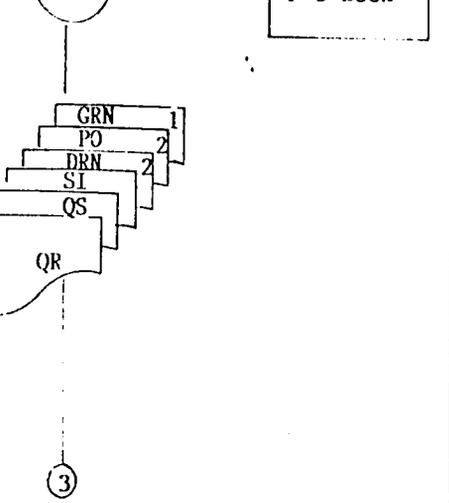
- o Purchases of items of Rs 3,000 to Rs 25,000 in value, are authorised by the Accountant. However all such authorisations are also endorsed by the Secretary to the Board.

- o Approval thus is required by two or more officials.
- o If the purchases are over Rs 25,000 in value the approval of the Secretary is sought and if the value exceeds Rs 100,000 the Director's approval is sought. However, such authorisation is subject to tender board approval.
- o If the work is of a specialised technical nature, relating to a specific department, the hiring, receiving, evaluating and approving of payment is done under the direct control of the head of the respective division. However an independent opinion from a subject specialist is obtained in support of payment.
- o We, therefore recommend multiparty approval and segregation of duties, wherever possible.
- o There are no standard rates of emolument specified for scientific or consultancy work. It was, however, brought to our attention that this issue was being taken up at national level.

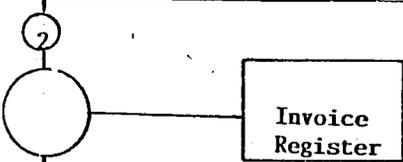
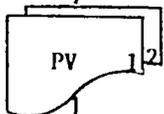
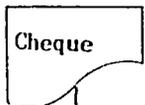
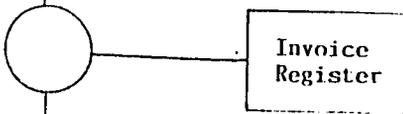
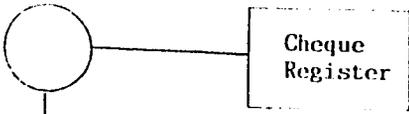
**INSTITUTE OF FUNDAMENTAL STUDIES (IFS)
PURCHASING AND PAYMENT - SYSTEMS FLOWCHART**



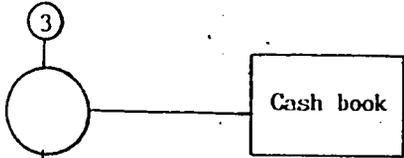
INSTITUTE OF FUNDAMENTAL STUDIES (IFS)
PURCHASING AND PAYMENTS – SYSTEMS FLOWCHART

NARRATIVE	OP NO	PAGE 2
Daily - Purchase Assistant brings invoices together with the goods	9	
Daily - At the gate goods are physically verified by, the security and suppliers invoice is stamped	10	
Daily - Suppliers / invoice details are entered in a register maintained by the security	11	
Daily - Purchase Assistant raises a Goods Received Note (GRN) with 2 copies. He checks the arithmetical accuracy of the invoices too.	12	
Daily - Purchase Assistant enters details of GRN and supplier invoices in the PO book.	13	
Daily - Following documents are sent to accounts department by the Purchase Assistant <ul style="list-style-type: none"> o Quotations received o Quotations schedule o Supplier Invoice o DRN copy 2 o PO copy 2 o GRN copy 1 	14	

INSTITUTE OF FUNDAMENTAL STUDIES (IFS)
PURCHASING AND PAYMENTS – SYSTEMS FLOWCHART

NARRATIVE	OP NO	PAGE 3
Daily - Cashier numbers all the invoices received and enters them in an invoice register.	15	
Daily - Cashier raises a payment voucher with 2 copies. Payment vouchers are raised in the serial order of invoices.	16	
Daily - Senior Accounts Assistant checks payment vouchers with all supporting documents received from the Purchase Assistant.	17	
Daily - Payment vouchers are approved by the Accountant after reviewing supporting documents.	18	
Daily - Payment vouchers are sent back to the cashier for raising of cheques. After raising of cheques, payment vouchers are serially numbered.	19	
Daily - After cheques are written all supporting documents are cancelled by the cashier using a dated "PAID" stamp.	20	
Daily - After cheques are written, the cheque number is entered in the invoice register.	21	
Daily - After cheques are written the cheque details are entered in the cheque register.	22	

**INSTITUTE OF FUNDAMENTAL STUDIES (IFS)
PURCHASE AND PAYMENTS – SYSTEMS FLOWCHART**

NARRATIVE	OP NO	PAGE 4
Daily - Cash book is updated at the sametime.	23	
Daily - Accountant checks the payment voucher to the amount shown in the cheque and signs them. At the same time he initials the cash book.	24	
Daily - Payment vouchers and cheques are sent to the secretary to the institute who also acts (ex-officio) as the secretary to board, for second signature.	25	
Daily - Payment vouchers are signed and cheques are sent back to the cashier for despatch.	26	
Daily - Senior Accounts Assistant enters details of cheques to be posted, in the mail register. Cheques are handed over to the Office Assistant in the Director's office after obtaining his signature.	27	
Daily - Signature is obtained on the payment voucher for cheques handed over.	28	
<p>At the end of the month :</p> <p>Senior Accounts Assistant totals payment cash book and its analysis columns. Totals of the analysis columns are posted to the General Ledger.</p>	29	 <p style="text-align: center;">E</p>

CHAPTER 4

TASK - (D)

"REVIEW AND COMMENT ON THE INTERNAL CONTROL SYSTEM TO DETERMINE:

- (a) THE ADEQUACY OF SEGREGATION OF DUTIES AND RESPONSIBILITIES IN THE FOLLOWING FUNCTIONAL AREAS:*
 - (1) ACCOUNTING,*
 - (2) PROCUREMENT (CONTRACTING),*
 - (3) VOUCHER PAYMENTS,*
 - (4) REPORTING; AND*
 - (b) THE EFFECTIVENESS OF THE CURRENT INTERNAL CONTROL SYSTEM ON THE MANAGEMENT OF FUNDS"*
-

Segregation of duties

4.1 Our observations on the segregation of duties and responsibilities between the functional areas of accounting, procurement, collection, payment and reporting are set out below. However, we must state that we did not observe any malpractices during the course of our work.

Cashier

4.2 The cashier performs the following functions:

- o Preparation of payroll
- o Writing of payroll cheques
- o Preparation of payment vouchers

- o Having custody of the petty cash imprest (Rs 20,000)
- o Raising of petty cash vouchers
- o Writing of payment cash book and receipt cash book
- o Raising of receipts
- o Having custody of cash
- o Preparation of cheque acknowledgement forms
- o Payment of salary advances
- o Payment of other advances
- o Maintenance of invoice register
- o Maintenance of fixed deposit register
- o Maintenance of festival advance register
- o Maintenance of staff welfare contribution register

4.3 If the cashier is given responsibility to handle the cash balance as well as the related documents then any cash losses or defalcations could be concealed by altering the related documents and records. We therefore, recommend that the cashier should only carry out functions connected with handling of cash and that the preparations of documents and writing up of books be handed over to other officials of the accounts department.

Laboratory Manager

4.4 The Laboratory Manager performs the following functions:

- o Raising DRNs for purchases for general stores
- o Membership of the quotation evaluation committee for representation on technical matters
- o Having the custody of the glass and chemical stocks
- o Raising of GRNs for chemical and glassware items
- o Raising of GRNs for gifted items
- o Maintenance of fixed asset inventory in the computer
- o Maintenance of the bin cards
- o Analysis and valuation of DRNs raised by each project at the end of each month
- o Providing technical information for scientists on chemicals, equipment etc.
- o Training of personnel to handle sophisticated equipments
- o Operation of NMR spectro meter and MASS spectro meter
- o Being incharge of other equipment (eg: HPLC setup, IR and FTIR gass chematograph etc)

4.5 For effective control we recommend that the maintenance of the stores ledger be carried out at the accounts department.

Purchase Assistant

4.6 The purchase assistant carries on the following functions:

- o Raising of purchase orders

- o Maintenance of purchase register
- o Posting of purchase orders to suppliers
- o Purchasing and collection of goods
- o Sending documents (ie DRNs, purchase orders, GRNs, supplier invoices to accounts department for payments)
- o Sending details of fixed asset purchases (Fixed Assets Voucher) to laboratory manager
- o Obtaining hand quotations for purchases below Rs 3,000 from registered suppliers in Kandy (This is not evaluated by the tender board)
- o Maintenance of stores register
- o Having the custody of stationery and sundry items
- o Gate pass checking

4.7 We take the view that the function of obtaining hand quotations for purchases of less than Rs 3,000 and the subsequent collection of goods, to be incompatible. To avoid this, we recommend that these functions be given to two separate persons.

4.8 We also consider the functions of placing of orders and subsequent receipt of goods to be incompatible. However, in the case of receipt of goods, these are checked at the gate by the security. Further, the Accountant checks the purchase order with the endorsement for the receipts of goods at the security. Therefore the present system could be allowed to continue.

Budgetary control system

- 4.9 The effectiveness of the fund management at IFS is dependent, largely, upon the budgetary control system in operation. Budgets are prepared annually and the funds released by the donors and the Government of Sri Lanka (GOSL) depending on the amount approved. Therefore expenditure is controlled only to the extent that the budgets are not exceeded.
- 4.10 Presently the departmental budgets as well as the project budgets are prepared by department Heads with no involvement by the accounting personnel. We observed instances where there had been differences in classifications and estimations which had resulted in certain line items within the budgets being inadequate while savings were experienced in other line items. Savings made on line items of revenue nature with the exception of salaries are permitted to be utilized on other recurrent expenditure. However such intermingling between revenue and capital expenditure as stated in the budget, is disallowed, resulting in certain disagreements between the Heads of department and the Accounts unit.
- 4.11 This could be overcome by the involvement of accounting personnel in the budgetary process. This could also be achieved by the appointment of a budget officer to coordinate the budgetary functions of the Institute.

Value for money

- 4.12 Unlike commercial enterprises, non profit making organisations such as IFS should develop a different set of criteria to assess their performance. Value-for-money (VFM) reviews will enable the Institute to assess its performance.

4.13 VFM reviews must cover the "three Es" - Economy, Efficiency and Effectiveness. Although these terms, in practice, tend to overlap in meaning, they could be defined as follows:

Economy: The practice by management of virtues of thrift and good housekeeping. An economical operation acquires resources in appropriate quality and quantity at the lowest cost.

Efficiency: Making sure that the maximum useful output is gained from the resources devoted to each activity, or, that only the minimum level of energy and work necessary is used for a given level of output.

Effectiveness: Ensuring that the output from any given activity is achieving the desired result.

4.14 Accordingly we suggest that IFS develop a series of performance and cost indicators which could be used as a guide to evaluate the economy of transactions, efficiency of operations and the effectiveness of achieving project and corporate objectives of IFS.

CHAPTER 5

TASK - (E)

"REVIEW AND COMMENT ON THE CONTRACT MANAGEMENT CAPABILITIES AND PROCEDURES TO ADVERTISE, SOLICIT, NEGOTIATE, AWARD AND ADMINISTER CONTRACTS BOTH FOR COMMODITIES AND SERVICES.

WITH REGARD TO THE ABOVE, REVIEW AND COMMENT ON THE NATURE AND TYPE OF CONTRACTS EXECUTED BY THE ORGANISATION. IS CONTRACTING FOR SERVICES OR COMMODITIES A REGULAR AND CONTINUING FUNCTION OF THE ORGANISATION? IF NOT, IS THE PROCUREMENT TO BE UNDERTAKEN LIKELY TO BE A LIMITED OR ISOLATED EXPERIENCE WITH LITTLE OR NO INSTITUTIONAL BENEFIT WARRANTING USE OF THE HOST COUNTRY CONTRACTING MODE? IS THE ORGANISATION FAMILIAR WITH CONSTRUCTION CONTRACTING ? DOES THE ORGANISATION FUNCTION WITH REASONABLE EFFICIENCY AND RESPONSIVENESS TO SCHEDULE DEADLINES? ALSO, ARE THERE TECHNICALLY QUALIFIED PROCUREMENT OFFICIALS WHO ARE CAPABLE OF SOLICITING COMPETITION, EVALUATING, AND SELECTING CONTRACTORS?

FURTHER, IN CONNECTION WITH THE ABOVE, AN ASSESSMENT OF THE CONTRACTING MANUALS, REGULATIONS AND GUIDELINES SHOULD BE CARRIED OUT. THIS SHOULD INCLUDE DOCUMENTING THE TENDERING PROCEDURES OF THE ORGANISATION".

Contracts for services

5.1 IFS enters into the following types of contracts:

- o Janitorial services
- o Cafeteria services
- o Security services
- o Garden maintenance
- o Staff transport
- o Pest control

- o Internal audit of IFS
- o Wharf clearance /clearing agents

5.2 The contracts for these services are entered into for a period of one year and are generally renewable at the end of each year. However, there have been instances in the past where the contracts have been awarded to the same contractors without calling for new tenders. This procedure has been adopted where the contractee does not require a price revision for the ensuing year.

Supply of materials

5.3 The materials purchased by IFS are mostly chemicals, laboratory equipment and glassware purchased for the laboratories, stationery and consumable items.

5.4 Purchase of stationery and consumable items are done on a replenishment basis. There are registered/preselected suppliers for these purchases. The value of these items amount to less than 1% of the total purchases for the year. No tender procedures are in existence for items less than Rs 1,000 in value as it may not be cost effective to follow tender procedures for these procurement.

5.5 The chemical purchases are divided into two categories.

- o General chemicals
- o Specific chemicals

5.6 The purchase of general chemicals is now done once every year. The requirements of these chemicals for each department are assessed at the commencement of each year. This enables IFS to place bulk orders and achieve economies of scale.

5.7 The purchases of specific chemicals are done as and when required. The supplier is selected and recommended by the head of the department. Quotations are called for only if the Accountant thinks it necessary. The specification and the urgency of requirements are also taken into account in deciding to call for tenders.

Capital projects

5.8 Most of the buildings and infrastructure requirements of IFS have already been met. Additionally a large amount of the equipment as required have been supplied by way of grants in kind by donors. As such, the procurement of capital items is limited to a few items.

5.9 IFS has, to date, entered into only one construction contract for the construction of a "Green House". This construction has been awarded to an outside contractor after calling for sealed tenders and a technical evaluation of the bids. The work was carried out according to the detailed specifications given by the Earth Science Department.

Tender procedure

5.10 Tenders are called for from registered suppliers of IFS. A minimum of five quotations are called for from potential suppliers. Quotations for materials are called for directly from the suppliers registered with the IFS while tenders for the services are advertised in the newspapers.

5.11 IFS adopts the following limits in calling for quotations / tenders

- o For the procurement of items upto Rs 1,000 no quotations are required.

- o Rs 1,000 - Rs 3,000 hand quotations are entertained.
- o Re 3,000 - Rs 25,000 quotations are invited from registered suppliers.
- o Rs 25,000 - Rs 100,000 sealed quotations are invited.
- o If the item to be purchased is over Rs 100,000 in value, then tenders are called for.

5.12 Quotations are received and evaluated by the tender board comprising:

- o The Director
- o Laboratory Manager
- o Secretary to the institute who is (ex-officio) secretary to the Board
- o Head of the Physical & Chemical Science/Department (Professor Tennakoon)
- o Head of the Environmental Sciences Department (Dr Ivon Silva)

5.13 The quotations are selected generally with emphasis on the prices quoted. However, a strict set of criteria is not maintained due to the diversity of the items being purchased.

5.14 IFS maintains a computer data base of possible suppliers of chemicals and other materials. Suppliers who have previously failed to maintain the standards and specifications are flagged (ie black listed). This ensures that no future contracts are entered into with such suppliers.

5.15 IFS has a formal method of registration of suppliers (local and overseas). As a result all potential suppliers are registered with IFS. We recommend that IFS should establish procedures to call for the registration of suppliers on a periodic basis and keep the suppliers list updated at all times.

Criteria for selection of suppliers

5.16 The practice of minuting the selection criteria used by the Tender Board in evaluating tenders, facilitates the effective review by an independent third party of tenders awarded.

5.17 Chemical procurements of IFS are of analytical grade and not of the usually marketed commercial grades. As such the selection criteria are strictly qualitative and technical in nature. Very few suppliers satisfy these criteria. Considering these factors we have no reason to doubt the integrity of the tender board decisions.

5.18 To enhance the effectiveness of the tender procedures we recommend that the subsequent supply should be compared with the criteria on which the supplier was selected to ensure that such criteria are in fact, adhered to.

Contracting manuals regulations and guidelines

5.19 IFS has developed a 'Manual of Procedures' which is frequently referred to, in interpreting the Act on all practical aspects of its operations.

CHAPTER 6

TASK - (F)

"REVIEW AND DOCUMENT THE INVENTORY CONTROL PROCEDURES OF THE ORGANISATION. THIS SHOULD INCLUDE THE INVENTORY CONTROL PROCEDURES AND THE COMMODITY ARRIVAL AND DISPOSITION SYSTEMS. ALSO REVIEW AND COMMENT ON THE ADEQUACY OF MAINTENANCE OF THE FIXED ASSETS REGISTERS OF THE ORGANISATION"

Commodity arrivals

- 6.1 Consumable materials and fixed assets are purchased in accordance with the procedures set out in chapter three.
- 6.2 The assistant to the Laboratory Manager enters inputs from the Goods Received Notes (GRNs) into the stock records maintained at the laboratory. Bin cards are also maintained by the laboratory manager for each item. The GRNs are serially numbered and the input is controlled for completeness by a check on the serial sequence. (See paragraph 6.8).

Issues

- 6.3 The Laboratory Manager has adopted a practice of adding 10% to the cost of issues as there had not been a proper system of accounting for stock holding costs and related overheads at IFS, in previous periods. He has not rectified this programmed procedure, even after the present system of accurate accounting and overhead absorption techniques came into existence. As a result there has been an element of double charge of overheads relating to stocks being apportioned to project accounts.

- 6.4 As the issues are recorded at cost plus 10%, the stock record always understates the value (cost) of stocks in hand. This can also result in certain stock cards showing negative values.
- 6.5 This was brought to the attention of the Accountant who assured us that he would liaise with the Laboratory Manager and rectify the project costs.
- 6.6 We were also informed that stock and cash counts are performed during the monthly internal audit carried out by an independent firm of Accountants. Stock losses if any, are immediately investigated, explanations are called for and action taken to rectify any errors.
- 6.7 This ensures the safeguarding of stocks and accuracy in recording receipts and dispatches.

Serial sequence of DRNs

- 6.8 Separate DRN books are given to each of the departments. Therefore it is difficult to check the serial sequence of the DRNs used and thus ensure that all issues made have been accounted for and the cost charged to the relevant project.
- 6.9 To establish control over the completeness of input of DRNs for processing, the computer could be programmed to automatically check the serial sequence of the DRNs and generate an exception report of missing and/or duplicate numbers. Alternatively a manual register could be maintained to enter the DRN numbers on which issues are made. All missing DRNs should be investigated and cancelled. DRNs must be checked to ensure that no issues had been made on those already cancelled.

GRN reference number

- 6.10 Although GRNs raised by the Laboratory Manager are in serial order there is no check carried out to ensure that all GRNs have been input for computer processing. Further an independent check of completeness of input cannot be carried out because the GRN numbers are not entered in the bin cards or stores ledger. Since GRNs are filed department wise, should the need arise, a receipt cannot be checked back to its GRN or the serial sequence cannot be established without rearranging all GRNs.
- 6.11 To overcome this weakness, we recommend that a separate column be opened in the bin cards and stores ledger to record the GRN number. Further the computer program should be modified to produce a listing of missing or duplicate GRN numbers updated to stock records.

Margin on cost of stocks

- 6.12 As explained in paragraph 6.3 above, stocks are charged to the individual projects at cost plus 10%. This margin of 10% is not separately accounted for at present and continues as a deduction against the cost of stock items in the stock master file. As a result the cost of stocks in the ledger account will be understated by the accumulated margin on issues made to date.

Stationery and sundry items

- 6.13 Records relating to stocks of stationery, sundry items, chemicals and glassware are kept by the same system. However the custody of stocks of stationery and sundry items is with the purchase assistant, who also maintains the stock records.
- 6.14 The weaknesses documented in paragraphs 6.8 and 6.11 above are also applicable to those stock records relating to these items.

Fixed asset register

6.15 IFS maintains a fixed asset register (FAR) giving the following details.

- o Ledger folio number
- o Name of the asset
- o Department
- o Location of the asset
- o Code number
- o Description
- o Year of purchase
- o Rate of Depreciation
- o Remarks
- o Cost/valuation
- o Depreciation brought forward
- o Annual depreciation
- o Accumulated depreciation
- o Written down value
- o Sales proceeds
- o Profit/loss on disposal

- 6.16 No FAR had been maintained prior to December 1992, and the present one was compiled from a 100% physical verification carried out by the auditors in December 1992.
- 6.17 At the time of our inspection, the following details had not been properly updated.
- o Department to which the asset belongs
 - o Location of asset
 - o Details of depreciation
- 6.18 Further, no procedures had been established to ensure that transfer of fixed assets between locations or departments were documented, and the FAR updated accordingly.
- 6.19 If the FAR is not kept updated, it would be difficult to agree the records with a physical count and thereby control the movement of assets. Further, if the FAR is kept updated, the management or third parties such as the auditors would be able to carry out a verification of fixed assets.

Fixed assets received as grants in kind

- 6.20 The fixed assets received as grants in kind had not been accounted for in the books of account in previous periods. As a result, the fund balance and the fixed assets are understated in the books of account. Presently, (from 1992) fixed assets received as grants in kind are accounted for in the books of account. These, however, have not been recorded in the FAR.
- 6.21 Due to the above, the total of fixed assets, stated in the FAR differs from the amount shown in the books of account.

6.22 We recommend that steps be taken to reconcile these differences and adjustments be made in the FAR and the books of account. This will enable IFS to ensure that a complete record of all fixed assets purchased or received in kind is maintained.

Fixed assets purchased out of restricted grant funds

6.23 Fixed assets purchased out of grant funds are considered to be the property of the project until the completion of the project. Therefore such assets are not included in the FAR until the termination of the project. At the conclusion of the project, such assets are entered in the FAR on the advice of the head of the department/project leader. However we are of the opinion that the risk of such assets going undetected is high, if there are any losses or pilferages.

6.24 To overcome this weakness we recommend that all such fixed assets be recorded in the FAR at the time of purchase. The ownership could be indicated by a special note in the FAR folio or by recording these in a separate section of the FAR to register the title of Project Fixed Assets. When a fixed asset is transferred from a project to IFS such transfer should be recorded for this purpose serially.

6.25 The Accountant, informed us that when assets are purchased using grants, the grant account is credited and the project current account is debited. On completion of the project all assets in the project current account are transferred into the fixed asset accounts of IFS. He was of the opinion that the chances of items being missed out at this stage is rare.

6.26 However he was prepared to give consideration to the safe and good practices, recommended by us.

Gate pass control

6.27 Gate passes are used to exercise control over the despatch of fixed assets. Gate passes are raised with the following four copies:

Copy 1 To Applicant

Copy 2 To accounts department

Copy 3 To purchase assistant

Copy 4 To security

6.28 At the gates, the security personnel check the items being taken out of the premises with the gate pass and file a copy of the gate pass at the security office. When the items so removed are returned, the security checks them against the original gate pass and return their copy to the purchasing assistant, who compares it with his copy to ensure that the items are correctly returned. The security also periodically checks on items not returned within a reasonable period of time.

6.29 We, however, observed that the purchasing assistant had not filed the gate passes in serial order. As a result it would be difficult to ensure the completeness of gate passes being returned to him.

6.30 We recommend that the gate passes be maintained in serial order with the production assistant and the security.

FAR maintained at the laboratory

6.31 A separate, computerised FAR is maintained by the laboratory manager using GRNs. This is maintained solely for his reference.

6.32 As a result, the maintenance of the FAR is duplicated. Further, no attempt has been made to reconcile the two FARs. We have not carried out an audit of the FAR since it is beyond the scope of our work.

CHAPTER 7

TASK - (G)

"REVIEW AND COMMENT ON THE COMPLIANCE WITH LAWS AND REGULATIONS BY THE AGENCY"

Compliance with laws and regulations

- 7.1 Our examination of the accounting systems, internal controls and managerial practices of IFS revealed that the administration of the institute is done in accordance with the laws of the country and good financial practices.
- 7.2 However with regard to the management of the provident fund, the following specific rules as per the constitution of the fund had not been complied with prior to 31 December 1992.

Rule 13 : Contributions of the employees should be credited to a bank account of the fund before the first day of the month following the month in which contributions were received. No funds had been lodged in a bank account until January 1991, though such funds had been subtracted from the payroll.

Rule 19 : Books of account of the fund should be maintained separately showing the contributions of each member.

Rule 28 : Accounts of the fund should be prepared and audited for each calendar year.

- 7.3 The above breaches of law were rectified as from 1 January 1993. A separate set of books is now being maintained and each member's contribution to the provident fund, is separately shown . A separate book keeper has been assigned for this task.
- 7.4 IFS has not paid ETF during the period 1984 to 1990. This has resulted in a surcharge payment of Rs 89,801.81. However during 1993, ETF payments were made on due dates and no surcharge has been levied.

CHAPTER 8

TASK - (H)

"REVIEW THE ADEQUACY OF THE RECORDING AND REPORTING PROCEDURES OF THE COUNTERPART CONTRIBUTION UNDER THE AID GRANT"

Counterpart contribution

- 8.1 According to the project agreements, IFS should contribute from its own resources either in cash or in kind not less than 25% of the cost of the activity.
- 8.2 Counterpart contribution is made up as follows
- o Salaries of four senior scientists engaged in the project
 - o Salaries and allowances of the research assistants
 - o Service wages of two laboratory assistants
 - o Time cost of Accounts assistant and other staff to maintain project ledger.
 - o Overhead expenses including usage of laboratory equipment etc.
 - o Setting up and upgrading three new laboratories for the NAREP project at a cost of Rs 2.2 million.

- 8.3 Although the above expenditure is incurred on the projects, these are not charged to the projects. In particular, the above expenditure is common to several projects, and as such, the basis of allocation to the AID funded project had not been determined.
- 8.4 However, if the donors, and in particular USAID, require the counterpart contribution to be reflected in the books of account, then IFS should maintain subsidiary books of account on a project by project basis; to allocate overhead expenses to each project on a time basis. Further, the academic staff should submit time sheets to enable apportionment of the direct costs of such staff to the different projects.
- 8.5 If you require our assistance to set up such an accounting system, please let us know.