

**Regional Inspector General for Audit  
San José, Costa Rica**

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**Audit of USAID/Honduras's  
Irrigation Development Project  
Activities Managed by the  
National Directorate of Water Resources  
September 1, 1988 to December 31, 1992**

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**Audit Report No. 1-522-95-07-N  
March 14, 1995**



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March 14, 1995

**MEMORANDUM**

TO: USAID/Honduras Director, Marshall D. Brown

FROM: RIG/A/San José, *Christine A. Gothard*  
Christine A. Gothard

SUBJECT: Audit of USAID/Honduras's Irrigation Development Project Activities, Managed by the National Directorate of Water Resources, September 1, 1988 to December 31, 1992

This report presents the results of a financial audit of the Irrigation Development Project, USAID/Honduras Project No. 522-0268, activities managed by the Project Implementation Unit (Implementation Unit) of the National Directorate of Water Resources, for the period September 1, 1988 to December 31, 1992. The audit firm of Price Waterhouse prepared the report dated October 17, 1994.

The project's goal is to enhance the earning potential of Honduran farmers. The purpose of the project is to improve farmer productivity and production by providing irrigation technology and on-farm technical assistance related to improved agricultural practices. As of the end of the audit period, USAID/Honduras had obligated \$4,000,000 under the loan agreement and \$15,090,000 under the grant agreement. As a counterpart contribution, the Government of Honduras was to provide an equivalent of \$10,480,000. The audit covered disbursements of USAID funds of approximately \$7,392,317 (Lempiras 39,918,515 equivalent at the exchange rate at the end of the audit period).

The objectives of the audit were to determine whether: (1) the Implementation Unit's fund accountability statement presents fairly, in all material respects, the project's receipts and expenditures for the period, (2) the internal control structure of the Implementation Unit was adequate to manage the project's activities, and (3) the Implementation Unit complied with the terms of the agreement and applicable laws and regulations. The

scope of the audit included an examination of the project's activities and transactions to the extent considered necessary to issue a report thereon for the audit period.

Price Waterhouse concluded that the fund accountability statement presents fairly, in all material respects, the Implementation Unit's receipts and expenditures under the agreements, except for questionable costs of \$831,928. This amount consisted of questioned costs of \$645,320 related to maintenance costs incurred outside of the project and credit extended to ineligible beneficiaries and unsupported costs of \$186,608 related to materials and supplies that have no supporting documentation.

Price Waterhouse further qualified its opinion on the fund accountability statement because of an unreconciled difference of \$1,943,174 between funds provided to the Implementation Unit and the entity's recorded amounts. Following the audit firm's release of the audit report, USAID personnel worked with the Implementing Unit to satisfactorily reconcile this difference. Therefore, we are making no recommendation concerning the recovery of this unreconciled amount.

Regarding the internal control structure, the auditors identified two reportable and material weaknesses. The auditors found that the project did not: (1) have an adequate internal control structure to maintain a full accountability of available funds and (2) reconcile its accounting records with those of USAID/Honduras for reported funds received under the project.

Regarding the Implementing Unit's compliance with the terms of the agreements and applicable laws and regulations, the auditors identified five material instances of noncompliance. The auditors found that the Implementation Unit: (1) included in its fund accountability statements costs that did not have adequate documentation, (2) followed inappropriate procurement procedures for purchasing spare parts and services for the maintenance and repair of vehicles, (3) did not follow adequate procurement procedures and did not maintain proper records to support the receipts, withdrawals, and balance of inventories, (4) did not maintain adequate documentation to support per diem costs, and (5) allowed the banks participating in the project to grant credit to ineligible beneficiaries.

The project ended September 30, 1993, and according to USAID/Honduras officials, the Mission does not plan to use the Implementing Unit as an implementing entity in the future. Therefore, we are not recommending any action to correct procedural deficiencies identified by the auditors with respect to the Implementing Unit's internal control structure and compliance.

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

**Recommendation No. 1**

**We recommend that USAID/Honduras resolve the questionable costs of \$831,928 (\$645,320 questioned and \$186,608 unsupported) identified in the Price Waterhouse report dated October 17, 1994, and recover from the Project Implementation Unit of the National Directorate of Water Resources the amounts determined to be unallowable.**

Recommendation No. 1 will be considered resolved upon USAID/Honduras' determination of the amount of recovery, and will be considered closed upon the recovery of funds, offset of funds, or issuance of a Bill for Collection.

The report was discussed with representatives of the Project Implementation Unit of the National Directorate of Water Resources who agreed with most of the findings and recommendations included in the report. Management of the Project Implementation Unit did not wish to issue any written comments for the Price Waterhouse report.

This final audit report is being transmitted to you for your action. Please advise this office within 30 days of actions planned or taken to resolve and close the recommendations.

**Regional Inspector General for Audit  
San José, Costa Rica**

**Audit of USAID/Honduras's  
Irrigation Development Project  
Activities Managed by the  
National Directorate of Water Resources  
September 1, 1988 to December 31, 1992**

**Audit Report No. 1-522-95-07-N  
March 14, 1995**

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER  
RESOURCES FOR THE PERIOD  
SEPTEMBER 1, 1988 TO DECEMBER 31, 1992

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

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## *Price Waterhouse*



October 17, 1994

Mr. Coinage N. Gothard  
Regional Inspector General for Audit  
United States Agency for International Development  
San José, Costa Rica, C.A.

Dear Mr. Gothard:

This report presents the results of our financial audit of The Irrigation Development Project USAID/Honduras' Project No. 522-0268, managed by the Project Implementation Unit of the National Directorate of Water Resources for the period of September 1, 1988 to December 31, 1992.

### BACKGROUND

On August 29, 1986, the Government of Honduras, acting through its Ministry of Finance and Public Credit, signed a combined loan and grant agreement with the United States Agency for International Development mission to Honduras (USAID/Honduras) to finance the Irrigation Development Project USAID/Honduras Project No. 522-0268. The project assistance completion date was September 30, 1993. The project's activities were implemented by the Ministry of Natural Resources through a Project Implementation Unit established within the National Directorate of Water Resources.

The total estimated project cost was US\$32,980,000. Under the agreement, as amended, USAID/Honduras was to provide US\$4,000,000 in loan funds and US\$18,500,000 in grant funds while the Government of Honduras was to provide an equivalent of US\$10,480,000 as a counterpart contribution. As of December 31, 1992, through project amendment No. 7 of March 15, 1991 USAID/Honduras had obligated US\$4,000,000 in loan funds and US\$15,090,000 in grant funds through seven project agreement amendments. The audit covered disbursements of A.I.D. funds equivalents to L39,918,515.

The project's goal is to enhance the earning potential of Honduran farmers. The purpose of the project is to improve farmer productivity and production by providing irrigation technology and on-farm technical assistance related to improved agricultural practices. The project is composed of four interrelated components:



1. Irrigation System Construction and Rehabilitation - It was expected that during the seven-year life of the project that 6,000 to 7,000 hectares would be brought under irrigation. A variety of technologies were to be used to construct micro, small, and medium-scale irrigation systems depending on the land parcel size. This component has five subcomponents:
  - (a) Micro Irrigation Systems - These systems are constructed for farm units of less than 5 hectares in size. For the most part, they are available to independent subsistence farmers who have had limited use of modern inputs. Infrastructure consists of a small retention dam or a temporary diversion structure without accompanying land leveling.
  - (b) Small-Scale Irrigation Systems - These systems benefitted farmers or groups of farmers with holdings from 6 to 50 hectares in size. The farmers in these cases have had some exposure to modern technology and produce enough to sell in the market. Water storage facilities include, among others, artificially constructed lakes or ponds and fabricated storage tanks.
  - (c) Medium-Scale Irrigation Systems - Irrigation systems were developed for farms of up to 150 hectares. These medium-scale systems are intended for individual farmers, cooperatives, producers' associations or agrarian reform groups. Within this beneficiary subset, the level of modern technology employed is extremely uneven, as is the degree of farmer participation in the market economy which ranges from subsistence production to export.
  - (d) Drainage and Flood Control Works - Drainage works were to be constructed, as needed, in association with medium and large irrigation systems, and (in some special cases) as independent subprojects not associated with irrigation.
  - (e) Rehabilitation - Under the project, rehabilitation of existing irrigation systems were financed when justified.
2. On-Farm Water Management - Under this component, technical assistance was provided to farmers to adopt new cropping patterns and modern agricultural inputs to take full advantage of the irrigation infrastructure. The assistance consisted of regular on-site consultations with project beneficiaries and included group and individual training.



3. Credit - Credit provided through the project enabled beneficiaries to finance construction of irrigation infrastructure and to underwrite the costs of production inputs needed to take full advantage of the infrastructure. Credit funds were channeled through participating banks under trust agreements. These banks lent directly to individual growers and legal entities and were responsible for recovering the loans made.

The Government of Honduras established a trust account mechanism, an Irrigation Financing Facility (IFF), within the Central Bank of Honduras, using US\$10,000,000 in A.I.D. loan resources, and the equivalent of US\$5,000,000 in counterpart local currency under the project. The trust funds were divided into two wholesale credit lines that are managed through commercial and agricultural development banks. One credit line furnished medium-term infrastructure credit. The second financed short-term production credit.

4. Institutional Development - This component of the project was directed at strengthening the capacity of Honduran public and private sector institutions to plan and implement irrigation programs. At a macro level, assistance was provided to the National Directorate of Water Resources (DRH) to upgrade its capability to develop the institutional and legal framework to establish an effective irrigation program (i.e., project-contracted technical assistance was provided to assist the DRH in: drafting a National Water Law and its implementing regulations, improving its administrative and managerial skills in such areas as planning for irrigation development, reviewing and approving of project proposals, contracting and supervising private sector construction, assessing and inventorying the country's needs for irrigation, and administering the National Water Law and the National Irrigation Plan).

The National Directorate of Water Resources, through its Project Implementation Unit, serves as the lead counterpart agency for the project. It is responsible for overseeing and coordinating the implementation of the project activities. The Project Implementation Unit are also responsible for:

- (a) Elaborating yearly implementation plans, and securing through the Ministry of Finance and Public Credit the counterpart resources needed for the project in a timely fashion;
- (b) Monitoring jointly with the Central Bank of Honduras, A.I.D. loan funds and the Government of Honduras' local currency used for the project's credit activities; and



- (c) Overseeing jointly with USAID/Honduras, the performance of the Irrigation Advisory Group (IAG) and private sector construction contractors, as well as supervising construction.

The Irrigation Advisory Group (IAG) is a joint venture between U.S. and Honduran private consulting firms. The expatriate partner of this joint venture firm provided technical assistance to the DRH in the overall planning and programming of project activities. The technical assistance included advice on revising the Draft National Water Law and drafting subsequent regulations, developing the National Irrigation Plan, revising the guidelines for construction norms and standards, and programming on-farm extension services. Additionally, the Honduran partner of the firm provided legal assistance in drafting the National Water Law and subsequent regulations, carried out the subproject feasibility studies, prepared and presented subproject proposals, and provided on-farm extension services.

As part of the project promotion effort, the IAG helped communities organize Water User Groups (WUGs) to manage and maintain irrigation systems. The function of the WUGs is to achieve direct beneficiary participation in identifying, installing and maintaining the irrigation systems, to play a role in assuring the repayment of loans, and to assist in the delivery of technical assistance.

#### AUDIT OBJECTIVES AND SCOPE

We were engaged to conduct a financial audit of the Irrigation Development Project, USAID/Honduras Project No. 522-0268, managed by the Project Implementation Unit of the National Directorate of Water Resources, for the period of September 1, 1988 to December 31, 1992.

Our audit was performed in accordance with generally accepted auditing standards and the Government Auditing Standards of the United States Comptroller General (1988 revision) and accordingly included the review of documentation, accounting records, the internal control structure and such other auditing procedures as we considered necessary in the circumstances to determine whether:

1. The fund accountability statements of A.I.D. loan and grant funds and the Government of Honduras counterpart funds of the Irrigation Development Project managed by the Project Implementing Unit of the National Directorate of Water Resources present fairly, in all material respects, the project's receipts and expenditures for the period September 1, 1988 to December 31, 1992, in accordance with the terms of the respective agreement.



2. The internal control structure of the Project Implementation Unit of the National Directorate of Water Resources is adequate to manage the project's operations.
3. The Project Implementation Unit of the National Directorate of Water Resources complied with agreement terms and applicable laws and regulations.

In the course of our audit we were alert to the possible existence of errors or irregularities and to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts, in accordance with the Statements on Auditing Standards Nos. 53 and 54 of the American Institute of Certified Public Accountants.

The major audit procedures performed during our work in order to meet the stated audit objectives were the following:

1. Receipts

- (a) We confirmed directly with USAID/Honduras, the Ministry of Finance and Public Credit, and the Central Bank of Honduras the loan and grant funds, counterpart funds, and the balances of the credit component, respectively, provided to the project as of December 31, 1992.
- (b) We confirmed directly with the custodian banks, the bank account balances of the rotating fund as of December 31, 1992.
- (c) We reviewed the bank account reconciliations, as of December 31, 1992.

2. Procurement

- (a) We conducted a detailed evaluation of the project's procurement procedures used during the period under review.
- (b) On a test basis, we reviewed purchases amounting to L2,608,129 (approximately 68 percent of total purchases) made by the project during the period under review to determine their authenticity and proper calculation and valuation.
- (c) For the purchases selected, we reviewed the project's receiving records to determine the completeness of purchases received as of December 31, 1992.
- (d) For the selected purchases, we reviewed the endorsement of checks paid by the banks.



3. Credits

- (a) We conducted an evaluation of control procedures used by the project during the period under review for granting and managing credits.
- (b) We conducted an evaluation of control procedures used by the participating banks during the period under review for the selection, granting, and recovery of loans.
- (c) We confirmed directly with the Central Bank of Honduras the individual balances of loans granted and the recoveries of principal and interests.
- (d) We reviewed 100 percent of the granted loans files.
- (e) We selectively visited 23 projects. During the visits we held interviews with the beneficiaries.

4. Fixed Assets

- (a) We conducted an evaluation of control procedures used by the project during the period under review to manage and safeguard fixed assets.
- (b) On a selective basis, we identified project fixed assets through physical inspections.
- (c) On a selective basis, we examined vehicle maintenance costs during the period under review and the use of spare parts and tires.

5. Payroll and Per Diem

- (a) We conducted an evaluation of control procedures used by the project during the period under review for personnel administration, preparation and payment of payrolls, and payment of per diem.
- (b) On a selective basis, we reviewed payrolls paid during the period amounting to L1,070,659 (14 percent of total payrolls) and traced the names and salaries of employees included in such payrolls to the personnel files.
- (c) From the payrolls selected for testing, we selected 15 employees and examined their respective personnel files, and compared the signatures of each employee to the signatures in the payrolls.



- (d) For the 15 selected employees, we compared the endorsements of payroll checks with the employees' signatures in the personnel files.
- (e) In combination with our field visits to the project offices in San Pedro Sula, Comayagua and Choluteca, we selectively tested the physical existence of employees included in the payrolls.
- (f) On a test basis, we examined the payrolls for per diem paid to employees for trips to the project regional offices and made tests of their authenticity and reasonableness.

#### 6. Accounting System and Reporting

- (a) We conducted an evaluation of the accounting system and records used by the project during the period under review to determine whether the system was sufficient to provide project financial information (the fund accountability statement) in accordance with the budget classifications defined in the project loan and grant agreements.
- (b) We reviewed the quarterly progress reports issued by the project to ascertain that the contents were in accordance with agreement terms.

#### 7. Field Visits

- (a) In May 1993, we made field visits to the project regional offices in San Pedro Sula, Comayagua and Choluteca.
- (b) In the project offices visited, we identified project employees receiving salaries from the grant funds.
- (c) We conducted physical inspections of fixed assets assigned to the regional offices visited.

### RESULTS OF AUDIT

#### Fund Accountability Statements

As described in Note 5 to the fund accountability statements, the Project Implementation Unit did not reconcile the funds provided by USAID/Honduras and the Government of Honduras to the Project Implementation Unit's accounting records and there is a net difference of L4,910,146, between the confirmations received from the funding entities and amounts recorded in the Project Implementation Unit's accounting records.



As described in Note 6 to the fund accountability statements our testing additionally identified questionable costs totaling L3,484,726. These costs arose from internal control structure weaknesses and instances of noncompliance as described in the separate reports included in the following sections of this audit report. Management has not established in the fund accountability statements the total effect of the internal control weaknesses and material noncompliance matters noted by us in our selective tests.

In our opinion, except for the effects on the fund accountability statements of the questionable costs and the adjustments, if any, as might have been determined to be necessary had we been able to review a reconciliation of funds as mentioned in the preceding paragraphs, the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras Counterpart funds of the Irrigation Development Project, USAID/Honduras Project No.522-0268, present fairly, in all material respects, the project's receipts and expenditures for the period September 1, 1988 to December 31, 1992, in accordance with the terms of the respective agreement with A.I.D.

#### Internal Control Structure

In planning and performing our audit of the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras counterpart funds of the Irrigation Development Project, USAID/Honduras Project No. 522-0268, managed by the Project Implementation Unit of the National Directorate of Water Resources from September 1, 1988 to December 31, 1992, we considered the Unit's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statements and not to provide assurance on the internal control structure.

In the course of our audit we noted the following findings that we consider to be material weaknesses under generally accepted auditing standards and the Government Auditing Standards of the United States Comptroller General (1988 revision).

1. The Project Implementation Unit did not establish and maintain an adequate internal control structure to conduct the project with full accountability of the available funds. (Finding 1).
2. The accounting system of the Project Implementation Unit was not designed to provide the necessary information that allows the reconciliation of the funds received from A.I.D. and the Government of Honduras with the disbursements recorded and the available funds (Finding 2).



## Compliance with Agreement Terms and Applicable Laws and Regulations

As part of obtaining reasonable assurance about whether the fund accountability statements of the Irrigation Development Project managed by the Project Implementation Unit of the National Directorate of Water Resources from September 1, 1988 to December 31, 1992, are free of material misstatement, we performed tests of the Unit's compliance with agreement terms and applicable laws and regulations. The results of our tests disclosed the following material instances of noncompliance:

1. The fund accountability statements include costs that do not have documentation to support that they are reasonable and eligible (Finding 1).
2. The procurement procedures for purchasing spare parts and services for the maintenance and repair of vehicles were not in accordance with A.I.D. regulations and project implementation letters (Finding 2).
3. The procurement procedures and the records and internal control of inventories of materials and supplies do not provide sufficient evidence to support the receipts, withdrawals and balance of inventories, and do not reduce to a relatively low level the risk that errors or irregularities in material amounts may occur and not be detected in the normal course of operations (Finding 3).
4. Per diem costs are not supported with documentation to demonstrate that they are allowable, allocable, and reasonable in accordance with respective regulations (Finding 4).
5. The credit department did not ensure that the banks participating in the program were complying with A.I.D. regulations for granting credit, which caused significant instances of noncompliance (Finding 5).

### MANAGEMENT COMMENTS

The draft of this report was discussed with representatives of the Project Implementation Unit of the National Directorate of Water Resources and USAID/Honduras, who expressed their agreement with the report contents. However, even though the representatives of the Project Implementation Unit expressed its accordance with the contents of this report, it was decided not to issue any written comments.

*Price Waterhouse*

Price Waterhouse

## *Price Waterhouse*



AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT OF  
THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

FUND ACCOUNTABILITY STATEMENTS

INDEPENDENT AUDITOR'S REPORT

We have audited the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras counterpart funds of the Irrigation Development Project, USAID/Honduras Project No. 522-0268, managed by the Project Implementation Unit of the National Directorate of Water Resources, for the period September 1, 1988 to December 31, 1992. These fund accountability statements are the responsibility of the Project Implementation Unit's management. Our responsibility is to express an opinion on these fund accountability statements based on our audit.

Except as indicated in the third and seventh paragraphs, we conducted our audit in accordance with generally accepted auditing standards and the Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the fund accountability statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall fund accountability statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We do not have an external quality control review by an unaffiliated audit organization as required by paragraph 46 of chapter 3 of the Government Auditing Standards because no such quality review program is offered by professional organizations in Honduras. We believe that the effect of this departure from the financial audit requirements of Government Auditing Standards is not material because we participate in the Price Waterhouse World Firm worldwide internal quality control program which requires that our Price Waterhouse - Honduras Office be subjected, every three years, to an extensive quality control review by audit partners and managers from other Price Waterhouse World Firm offices.



The accompanying fund accountability statements were prepared for the purpose of complying with Section B.5 (i), Part C of the project implementation letter No. 4 of the combined loan and grant agreement No. 522-0268 between USAID/Honduras and the Government of Honduras as discussed in Note 1, and are not intended to be a presentation in conformity with generally accepted accounting principles.

As described in Note 5 to the fund accountability statements, the Project Implementation Unit did not reconcile the funds provided by USAID/Honduras and the Government of Honduras to the Project Implementing Unit's accounting records and there is a net difference in excess of L4,910,146, between the confirmations received and the recorded amounts, for which we could not find evidence that the funds received were used in activities related with the project.

As described in Note 6 to the fund accountability statements, our testing identified questionable costs totaling L3,484,726. These costs arose from internal control structure weaknesses and instances of noncompliance as described in the separate reports included in the following sections of this audit report. Management has not established in the fund accountability statements the total effect of the internal control weaknesses and material noncompliance matters noted by us in our selective tests.

In our opinion, except for the effects on the fund accountability statements of the questionable costs, and the adjustments, if any, as might have been determined to be necessary had we been able to review a reconciliation of funds as mentioned in the two preceding paragraphs, the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras counterpart funds of the Irrigation Development Project, USAID/Honduras Project No.522-0268, present fairly, in all material respects, the project's receipts and expenditures for the period September 1, 1988 to December 31, 1992, in accordance with the terms of the respective agreements with A.I.D.

This report is intended solely for the use of the United States Agency for International Development, the Ministry of Natural Resources and the National Directorate of Water Resources. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

*Price Waterhouse*

July 9, 1993

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

FUND ACCOUNTABILITY STATEMENT  
A.I.D. LOAN AND GRANT FUNDS  
(Expressed in Lempiras - Note 1)

	BUDGET (NOTE 3)			ACTUAL			AVAILABLE (UNDER) OVER BUDGET			INELIGIBLE COSTS (NOTE 6)	UNSUPPORTED COSTS (NOTE 6)
	LOAN	GRANT	TOTAL	LOAN	GRANT	TOTAL	LOAN	GRANT	TOTAL		
RECEIPTS:											
Loan and Grant Agreement AID 522-0268	L 8,000,000	L37,000,000	L45,000,000	L 7,142,401	L 32,838,795	L 39,981,196	L 857,599	L 4,161,205	L 5,018,804		
DISBURSEMENTS:											
Technical Assistance		13,200,000	13,200,000		9,411,831	9,411,831		3,788,169	3,788,169		
Personnel		400,000	400,000					400,000	400,000		
Per Diem	940,000		940,000	34,598		34,598	905,402		905,402		
Training	100,000	2,750,000	2,850,000	413,178	1,317,704	1,730,882	(313,178)	1,432,296	1,119,118		
Credit	5,670,000	14,330,000	20,000,000	4,295,363	18,015,951	22,311,314	1,374,637	(3,685,951)	(2,311,314)	L3,294,176	
Vehicles	1,080,000	120,000	1,200,000	1,709,259	108,900	1,818,159	(629,259)	11,100	(618,159)		
Maintenance and Operation of Vehicles		1,500,000	1,500,000	105,173	1,671,918	1,777,091	(105,173)	(171,918)	(277,091)	190,550	
Equipment		1,800,000	1,800,000	443,363	1,167,603	1,610,966	(443,363)	632,397	189,034		
Materials and supplies	210,000	1,380,000	1,590,000	138,786	1,141,138	1,279,924	71,214	238,862	310,076		L1,007,685
Evaluation and audit		320,000	320,000		3,750	3,750		316,250	316,250		
Contingency		1,200,000	1,200,000					1,200,000	1,200,000		
TOTAL DISBURSEMENTS	<u>L8,000,000</u>	<u>L37,000,000</u>	<u>L45,000,000</u>	<u>7,139,720</u>	<u>32,838,795</u>	<u>39,978,515</u>	<u>860,280</u>	<u>4,161,205</u>	<u>5,021,485</u>	<u>L3,484,726</u>	<u>L1,007,685</u>
Excess of receipts over disbursements (Note 4)				<u>L 2,681</u>	<u>L</u>	<u>L 2,681</u>	<u>L (2,681)</u>	<u>L</u>	<u>L (2,681)</u>		

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

FUND ACCOUNTABILITY STATEMENT  
COUNTERPART FUNDS  
 (Expressed in Lempiras - Note 1)

	<u>Budget</u> <u>(Note 3)</u>	<u>Actual</u>	<u>Available</u> <u>over (under)</u> <u>budget</u>	<u>Unsupported</u> <u>Costs</u> <u>(Note 6)</u>
RECEIPTS:				
Counterpart funds				
Government of Honduras	<u>L20,960,000</u>	<u>L 19,621,176</u>	<u>L 1,338,824</u>	
DISBURSEMENTS:				
Personnel	8,980,000	7,772,440	1,207,560	
Per Diem	322,000	532,692	(210,692)	L 260,273
Training	100,000	32,430	67,570	
Credit	10,000,000	10,000,000		
Vehicles	1,000,000		1,000,000	
Maintenance of vehicles	94,000	127,360	(33,360)	
Equipment	400,000	71,386	328,614	7,744
Materials and supplies	<u>64,000</u>	<u>1,084,868</u>	<u>(1,020,868)</u>	<u>624,909</u>
TOTAL DISBURSEMENTS	<u>L20,960,000</u>	<u>19,621,176</u>	<u>1,338,824</u>	<u>L 892,926</u>
Excess of receipts over disbursements (Note 4)		<u>L</u>	<u>L</u>	

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

NOTES TO THE FUND ACCOUNTABILITY STATEMENTS

NOTE 1 - SUMMARY OF ACCOUNTING POLICIES:

The fund accountability statements of A.I.D. Loan and Grant funds and Government of Honduras counterpart funds of the Irrigation Development Project, USAID/Honduras Project No. 522-0268, managed by the Project Implementation Unit of the National Directorate of Natural Resources for the period September 1, 1988 to December 31, 1992, were prepared for the purpose of complying with Section B.5 (i), Part C of the project implementation letter No. 4 of the combined loan and grant agreement between USAID/Honduras and the Government of Honduras. The significant accounting policies adopted by the Project Implementation Unit of the Implementation Unit of Ministry of Natural Resources to manage the project are summarized as follows:

Basis of accounting -

The Project Implementation Unit of the National Directorate of Water Resources uses the system of budgetary execution of the Government of Honduras to report the project's operations. The classification of budget line items in this system differ substantially from the classification of the grant agreement budget line items. The cash basis is used in this system to record receipts and disbursements, which are recognized when they are received or disbursed, respectively.

Exchange rate -

The records of the project are kept in Honduran Lempiras, the official currency. The official exchange rate of two Lempiras for one United States Dollar remained constant until March 1990 when the Government of Honduras approved an interbank exchange market for most foreign exchange transactions. As of December 31, 1992, the exchange rate in this market was L5.40 to US\$1.00.

NOTE 2 - HISTORY AND OPERATIONS OF THE PROJECT:

On August 29, 1986, the Government of Honduras, acting through the Ministry of Finance and Public Credit, signed a combined loan and grant agreement with USAID/Honduras to meet the costs of carrying out the Irrigation Development Project, USAID/Honduras Project No.522-0268. The project assistance completion date was September 30, 1993.

The total estimated Project cost was US\$32,980,000. Under the agreement, as amended, USAID/Honduras was to provide US\$4,000,000 in loan funds and US\$18,500,000 in grant funds while the Government of Honduras was to provide and equivalent of US\$10,480,000 as its counterpart contribution. As of December 31, 1992, USAID/Honduras had obligated US\$4,000,000 in loan funds and US\$15,090,000 in grant funds through seven project agreement amendments. The audit covered disbursements of A.I.D. funds equivalent to L39,918,515.

The project's goal is to enhance the earning potential of Honduran farmers. The purpose of the project is to improve farmer productivity and production by providing irrigation technology and on-farm technical assistance related to improved agricultural practices. The project is composed of four interrelated components:

1. Irrigation System Construction and Rehabilitation - It was expected that during the seven-year life of the project that 6,000 to 7,000 hectares would be brought under irrigation. A variety of technologies were to be used to construct micro, small, and medium-scale irrigation systems depending on the land parcel size. This component has five subcomponents:
  - (a) Micro irrigation systems
  - (b) Small-scale irrigation systems
  - (c) Medium-scale irrigation systems
  - (d) Drainage and flood control works
  - (e) Rehabilitation
2. On-Farm Water Management - Under this component, technical assistance was provided to farmers to adopt new cropping patterns and modern agricultural inputs to take full advantage of the irrigation infrastructure. The assistance consisted of regular on-site consultations with project beneficiaries and included group and individual training.

3. Credit - Credit provided through the project enabled beneficiaries to finance construction of irrigation infrastructure and to underwrite the costs of the production inputs needed to take full advantage of the infrastructure. Credit funds were channeled through participating banks under trust agreements. These banks lent directly to individual growers and legal entities and were responsible for recovering the loans made.

The Government of Honduras established a trust account mechanism, an Irrigation Financing Facility (IFF), within the Central Bank of Honduras, using US\$10,000,000 in A.I.D. loan resources, and the equivalent of US\$5,000,000 in counterpart local currency under the project. The trust funds were divided into two wholesale credit lines managed through commercial and agricultural development banks. One credit line furnished medium-term infrastructure credit. The second financed short-term production credit.

4. Institutional Development - This component of the project was directed at strengthening the capacity of Honduran public and private sector institutions to plan and implement irrigation programs. At a macro level, assistance was provided to the National Directorate of Water Resources (DRH) to upgrade its capability to develop the institutional and legal framework to establish an effective irrigation program (i.e., project-contracted technical assistance was provided to assist the DRH in: drafting a National Water Law and its implementing regulations, improving its administrative and managerial skills in such areas as planning for irrigation development, reviewing and approving project proposals, contracting and supervising private sector construction, assessing and inventorying the country's needs for irrigation, and administering the National Water Law and the National Irrigation Plan).

#### NOTE 3 - BUDGET:

The project budget of A.I.D. funds includes disbursements amounting to L19,050,000 (US\$9,525,000) made directly by USAID/Honduras for the following concepts: (a) technical assistance amounting to L13,200,000 (US\$6,600,000); (b) training amounting to L2,850,000 (US\$1,425,000); and (c) acquisitions of fixed assets and other acquisitions amounting to L3,000,000 (US\$1,500,000).

The disbursement categories of the budget of A.I.D. loan and grant funds and Government of Honduras counterpart funds, as presented in the accompanying fund accountability statements, were approved by USAID/Honduras through project implementation letters.

NOTE 4 - EXCESS OF RECEIPTS OVER DISBURSEMENTS:

Excess of the project receipts over disbursements, as of December 31, 1992, is represented by net assets on the books of the Project Implementation Unit as follows:

	<u>EXPRESSED IN LEMPIRAS</u>	
Assets:		
Cash and investments	L	667,092
Fixed assets		266,049
Reimbursements in transit		408,218
Other account receivables		<u>7,498</u>
Total assets		<u>1,348,857</u>
Liabilities:		
Loans payable		(846,176)
Revolving fund payable		<u>(500,000)</u>
Total liabilities		<u>(1,346,176)</u>
Excess of receipts over disbursements	L	<u>2,681</u>

NOTE 5 - RECONCILIATION OF GRANT, LOAN AND COUNTERPART FUNDS:

The Project Implementation Unit did not reconcile the funds provided by USAID/Honduras and Government of Honduras to the Project Implementation Unit accounting records. As a result there are the following differences:

<u>Funds</u>	<u>Per Books</u>	<u>Received Confirmations</u>	<u>Differences</u>
Grant	L32,838,795	L39,700,559	L(6,861,764)
Loan	<u>7,142,401</u>	<u>10,773,778</u>	<u>(3,631,377)</u>
	<u>39,981,196</u>	<u>50,474,337</u>	<u>(10,493,141)</u>
Counterpart	<u>19,621,176</u>	<u>14,038,181</u>	<u>5,582,995</u>
TOTAL	<u>L59,602,372</u>	<u>L64,512,518</u>	<u>L(4,910,146)</u>

NOTE 6 - QUESTIONABLE COSTS:

Questionable project costs, as of December 31, 1992, are shown in the following page.

QUESTIONABLE COSTS  
INELIGIBLE UNSUPPORTED

A. A.I.D. funds -

I. Materials and supplies:

a) Purchases with no evidence of items being received in the Project warehouse. L744,602

b) Costs recorded for which no supporting documentation exists. 263,083

II. Maintenance and operation of vehicles:

a) Repairs and maintenance of vehicles which are not reasonable and allowable since they were incurred in workshops different than the project's workshop. L190,550

III. Credit component:

a) Credit granted to beneficiaries which do not qualify in accordance with the agreement's terms and credit regulations.

Total A.I.D. funds 3,294,176  
L3,484,726    L1,007,685

B. Counterpart funds

I. Per diem and other travel expenses within the country:

a) Per diem paid for trips to regional offices for which no evidence exists of the trips and for which no reports exist of activities performed during the trips. L 260,273

I. Materials and supplies:

a) Purchases with no evidence of items being received in the project warehouse. 172,909

Carried forward L3,484,726    L1,440,867

Brought forward	L3,484,726	L1,440,867
b) In-Kind contributions for which no supporting documentation exists.		452,000
III: <u>Equipment</u>		
a) Cost of equipment that was not located and for which no evidence of transfer to another office exists.		7,744
Total counterpart funds		<u>L 892,926</u>
Total funds	<u>L3,484,726</u>	<u>L1,900,611</u>

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AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

INTERNAL CONTROL STRUCTURE

INDEPENDENT AUDITOR'S REPORT

We have audited the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras counterpart funds of the Irrigation Development Project, USAID/Honduras Project No. 522-0268, managed by the Project Implementation Unit of National Directorate of Water Resources for the period September 1, 1988 to December 31, 1992, and have issued our report thereon dated July 9, 1993.

Except for not conducting an external quality control review by an unaffiliated audit organization and a limitation of scope imposed by the lack of reconciliation between Implementation Unit's accounting records and the records of USAID/Honduras and the Government of Honduras, as described further in our opinion on the fund accountability statements, we conducted our audit in accordance with generally accepted auditing standards and the Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement.

In planning and performing our audit of the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras counterpart funds of the Irrigation Development Project managed by the Project Implementation Unit of the National Directorate of Water Resources for the period September 1, 1988 to December 31, 1992, we considered the Unit's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the fund accountability statements and not to provide assurance on the internal control structure.

The management of the Project Implementation Unit of the National Directorate of Water Resources is responsible for establishing and maintaining an internal control structure. In



fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of 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 the fund accountability statements in accordance with the basis of accounting described in Note 1 to the fund accountability statements. 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 might become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

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

- Accounting process
- Budgetary process
- Procurement system
- Procedures for granting and recovering loans
- Payroll and per diem procedures
- Receipts and disbursements
- Fixed assets system

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 the following 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 judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the fund accountability statements.

1. The Project Implementation Unit did not establish and maintain an adequate internal control structure to conduct the project with the accountability of the available funds. (Finding 1).



2. The accounting system of the Project Implementation Unit was not designed to provide the necessary information that allows the reconciliation of the funds received from A.I.D. and the Government of Honduras with the recorded disbursements and the available funds (Finding 2).

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the fund accountability 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. However, we believe that the reportable conditions mentioned above are material weaknesses.

This report is intended solely for the use of the United States Agency for International Development, the Ministry of Natural Resources and the National Directorate of Water Resources. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

*Pricewaterhouse*

July 9, 1993

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

INTERNAL CONTROL STRUCTURE

FINDINGS

1. The Project Implementation Unit did not Establish and Maintain an Adequate Internal Control Structure to Conduct the Project with full Accountability of the Available Funds.

Condition:

We found important instances of noncompliance with the terms of the agreement and applicable A.I.D. and Government of Honduras regulations resulting in questionable costs for important amounts in the following areas:

- (a) Materials and supplies costs
- (b) Operation and maintenance of vehicles
- (c) Credit component
- (d) Per diem and travel expenses.

Criteria:

Chapter 4 of the Government Auditing Standards issued by the United States Comptroller General (1988 revision) establishes that a good internal control structure is essential to conduct government business with accountability and also makes it easier to achieve management objectives.

Cause:

The project implementation unit does not have a manual of policies and procedures and a supervision and control mechanism to provide reasonable assurance that agreement terms and applicable laws and regulations will be complied with and that the project's objectives will be achieved.

**Effect:**

As shown in Note 6 to the fund accountability statements significant amounts of questionable costs were noted for each of the above-mentioned areas. The total questionable costs noted through our selective testing was L3,484,726. The full amounts associated with the material internal control weaknesses and noncompliance matters noted by our audit has not been determined by the Project Implementation Unit.

**Recommendation:**

The Project Implementation Unit should establish control procedures manuals necessary to reinforce its internal control structure and establish better mechanisms for supervision to assure compliance with the procedures.

2. The Project Implementation Unit was Unable Reconcile of the Funds Received from A.I.D. and the Government of Honduras with the Recorded Disbursements and the Available Funds.

**Condition:**

As shown below, as of December 31, 1992, the Project Implementation Unit was unable or unwilling to attempt to reconcile and to clear up in the Project Implementation Unit's records the unreconciled differences of L6,861,764 and L3,631,377, respectively which emerged between A.I.D. confirmations of grant and loan funds and the accounting records of the Project Implementation Unit.

Additionally, as shown below there was an unreconciled difference of L5,582,995 in relation with the initial disbursements reported by the Government of Honduras:

<u>Funds</u>	<u>Per Books</u>	<u>Received Confirmations</u>	<u>Differences</u>
Grant	L32,838,795	L39,700,559	L(6,861,764)
Loan	<u>7,142,401</u>	<u>10,773,778</u>	<u>(3,631,377)</u>
	<u>39,981,196</u>	<u>50,474,337</u>	<u>(10,493,141)</u>
Counterpart	<u>19,621,176</u>	<u>14,038,181</u>	<u>5,582,995</u>
TOTAL	<u>L59,602,372</u>	<u>L64,512,518</u>	<u>L(4,910,146)</u>

**Criteria:**

The accounting system of the project should provide the means to reconcile the funds coming from the institutions that finance it.

**Cause:**

There were inadequacies in the Project Implementation Unit's accounting system design or operation which lead to the inability to reconcile the funds received, disbursed and available. For instance, the Project Implementation Unit did not keep track of which materials inventory were purchased directly by USAID/Honduras versus by the Project Implementation Unit, and evidently it did not have the information to reconcile the above differences since it did not respond to our request that it perform a reconciliation to identify the reason for the above differences.

**Effect:**

This finding affects the assertion that the fund accountability statements are complete and accurate.

**Recommendation:**

Project management should establish accounting systems and procedures for conducting monthly reconciliations of funds received, disbursed and available from all sources, and assign responsibility for the timely review of these reconciliations.

## *Price Waterhouse*



AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

COMPLIANCE WITH AGREEMENT TERMS AND  
APPLICABLE LAWS AND REGULATIONS

INDEPENDENT AUDITOR'S REPORT

We have audited the fund accountability statements of A.I.D. loan and grant funds and Government of Honduras counterpart funds of the Irrigation Development Project, USAID/Honduras Project, No. 522-0268, managed by the Project Implementation Unit of the National Directorate of Water Resources for the period September 1, 1988 to December 31, 1992, and have issued our report thereon dated July 9, 1993.

Except for not conducting an external quality control review by an unaffiliated audit organization and a limitation of scope imposed by the lack of reconciliation between the Project Implementation Unit's accounting records and the records of USAID/Honduras and the Government of Honduras as described further in our opinion on the fund accountability statements, we conducted our audit in accordance with generally accepted auditing standards and the Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statements are free of material misstatement.

Compliance with agreement terms and laws and regulations applicable to the Irrigation Development Project is the responsibility of the Project Implementation Unit of the National Directorate of Water Resources. As part of obtaining reasonable assurance about whether the fund accountability statements are free of material misstatement, we performed tests of the Project Implementation Unit's compliance with the terms of the agreement and certain provisions of laws and regulations. However, the objective of our audit of the fund accountability statements was not to provide an opinion on overall compliance with such terms and provisions. Accordingly, we do not express such an opinion.



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 these failures or violations is material to the fund accountability statements. The results of our tests of compliance disclosed the following material instances of noncompliance.

1. The fund accountability statements include costs that do not have documentation to support that they are reasonable and eligible (Finding 1).
2. The procurement procedures for purchasing spare parts and services for the maintenance and repair of vehicles were not in accordance with A.I.D. regulations and project implementation letters (Finding 2).
3. The procurement procedures and the records and internal control of inventories of materials and supplies do not provide sufficient evidence to support the receipts, withdrawals and balance of inventories, and do not reduce to a relatively low level the risk that errors or irregularities in material amounts may occur and not be detected in the normal course of operations (Finding 3).
4. Per diem costs are not supported with documentation to demonstrate that they are allowable, allocable, and reasonable in accordance with respective regulations (Finding 4).
5. The credit department did not ensure that the banks participating in the program were complying with A.I.D. regulations for granting credit, which caused significant instances of noncompliance (Finding 5).

We considered these material instances of noncompliance in forming our opinion on whether the fund accountability statements of the Irrigation Development Project managed by the Project Implementation Unit of the National Directorate of Water Resources for the period September 1, 1988 to December 31, 1992 are presented fairly, in all material respects, in conformity with the basis of accounting described in Note 1 to the fund accountability statements, and this report does affect our report dated July 9, 1993 on those fund accountability statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the Project Implementation Unit of the National Directorate of Water Resources complied, in all material respects, with the provisions referred to in the third paragraph of this report. However with respect to items not tested, because of the severity of the exceptions noted for the items tested and the uncertainties associated with those exceptions, and the limitations to our audit caused the lack of reconciliations to establish the amounts of funding received, disbursed and available,



we are not in position of express a negative assurance of compliance with those provisions.

This report is intended solely for the use of the United States Agency for International Development, the National Directorate of Water Resources and the Ministry of Natural Resources. This restriction is not intended to limit the distribution of this report which, upon acceptance by the Office of the Inspector General, is a matter of public record.

*Price Waterhouse*

July 9, 1993

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

COMPLIANCE WITH AGREEMENT TERMS AND  
APPLICABLE LAWS AND REGULATIONS

FINDINGS

1. The Fund Accountability Statements include costs that do not have documentation to support that they are reasonable and eligible.

Condition:

Our test of project disbursements revealed that the Project Implementation Unit does not have the documentation to support the disbursements made through payment orders for an amount of L263,083. Additionally there are various other instances of disbursements not properly supported amounting to L1,637,528.

Criteria:

A.I.D. handbook 11, chapter 4, section 2.4 establishes that the implementing entity must maintain accounts and records adequate to demonstrate the allowability, allocability, and reasonableness of costs, including their nature, amount, and derivation.

Cause:

The Project Implementation Unit did not establish adequate controls to ensure that transaction were properly documented.

Effect:

The above-mentioned disbursements are unsupported costs and are not eligible for reimbursement by USAID/Honduras.

Recommendation:

Project management should establish specific procedures for processing only transactions that are properly documented.

2. The Procurement Procedures for Purchasing Spare Parts and Services for the Maintenance and Repair of Vehicles Were not in Accordance with A.I.D. Regulations and Project Implementation Letters.

**Condition:**

Management personnel of the project Implementation Unit acquired vehicle repair services without previous bids and in the process by passed the employee responsible for providing or arranging for these services. In 22 percent of the cases these repairs were given to an ex-employee of the project while the rest they were given to outside workshops. In addition we found that the same management personnel that arranged for the services, received them, and delivered the checks to suppliers, which arrangement results in inadequate internal control over the acquisition of these services. The above occurred even though the Project Implementation Unit had hired a full time specialized mechanic whose responsibility it was to either repair the project's vehicles or to approve and receive the repairs done.

**Criteria:**

Part C, Article C of the project implementation letter No. 4 establishes the proper procurement procedures of goods and services. These procedures incorporate the requirements of A.I.D. Handbook 11, Chapter 1 regarding the procurement of technical services.

**Cause:**

The Project Implementation Unit lacked an adequate control environment for the management of the maintenance and repairs of the vehicles and the supervisory oversight of those functions.

**Effect:**

We consider that costs totaling L190,550 for external repair services of vehicles are ineligible because they bypassed the Project Implementation Unit employee responsible for preparing or arranging for the repair of vehicles. The costs are also questionable from the stand point that the procedure followed for contracting the services lacks documentation to support that the prices paid were reasonable.

**Recommendation:**

Project Implementation Unit management should establish an adequate internal control structure for requisitioning, bidding, and receiving repair and maintenance services for project vehicles in accordance with the regulations for procurement services established in the grant agreement and project implementation letters.

3. The Procurement Procedures and the Records and Internal Control of Inventories of Materials and Supplies do not Provide Sufficient Evidence to Support the Receipts, Withdrawals and Balance of Inventories, and do not Reduce to a Relatively Low level the Risk that Errors or Irregularities in Material Amounts May Occur and not be Detected in the Normal Course of Operations

Condition:

During the period from September 1, 1988 to December 31, 1992, the Project Implementation Unit did not maintain adequate records and controls over materials inventories to ensure that all purchases of materials were completely received and in the agreed upon condition. The controls not instituted were: (a) physical inventories were not taken to determine and investigate shortages or overages; (b) inventory control accounts in the general ledger were not reconciled with the detailed inventory records; and (c) an appropriate segregation of duties was not established, as the same persons in charge of purchases received the goods purchased.

During the course of our audit, we reviewed materials purchases of L2,608,129 from the total purchases of L3,820,893. This review showed that approximately L917,511 of the purchases (35 percent of the dollar value sampled) did not have evidence of being received by the project. The shortages noted follow:

<u>YEARS</u>	<u>AID FUNDS</u>	<u>COUNTERPART FUNDS</u>	<u>TOTAL</u>
1987		L 69,218	L 69,218
1988	L221,411		221,411
1989	228,325	103,691	332,016
1990	246,785		246,785
1991	<u>48,081</u>		<u>48,081</u>
	<u>L744,602</u>	<u>L172,909</u>	<u>L917,511</u>

Criteria:

The agreement standard provisions require the maintenance of accounts and records adequate to demonstrate the allowability, allocability, and reasonableness of costs charged to a project including their nature, amount and derivation.

Cause:

Project Implementation Unit management did not timely develop and establish procedures related to the procurement, control, and custody of inventory. They also did not require periodic physical inventories.

Effect:

The amounts quantified in the condition section above relate only to items in our sample lacking evidence of receipt. However the significance of this finding extends to the overall inadequate control and accountability for the materials and supplies inventories. We were unable to fully quantify the effect of this finding related to withdraws from inventory and remaining balances because the management of the Project Implementation refused to conduct a physical inventory and attempt to computed what the inventory balance on the date of the physical inventory should have been based upon a compilation of all inventory transactions. As a result, the Project Implementation Unit does not have assurance that project's materials and supplies inventories were received, and safeguarded and used for authorized purposes.

Recommendation:

Project Implementation Unit management should: (1) immediately develop and implement effective procedures related to the procurement, control, and custody of inventory, and (2) require the execution of a complete physical inventory as soon as possible. In addition, a complete reconstruction of inventory transactions and record is needed to establish computed quantities and amounts with which the results of the physical inventories can be compared to further establish and investigate shortages.

4. Per Diem Costs Are not Supported With the Necessary Documentation to Demonstrate Whether They are Allowable, Allocable, and Reasonable in Accordance with the Respective Regulations

Condition:

In our selective review of per diem disbursements made during the period from September 1, 1988 to December 31, 1992, we noted the following:

- (a) The expense liquidation reports were not prepared by employees that made trips to the regional offices of the project.
- (b) In most of the cases reviewed, we did not find evidence of the preparation of trip reports.

Criteria:

Regulations for Per Diem and Other Travel Expenses for Officers and Employees of the Government of Honduras published in Resolution No. 636 of November 14, 1977, in force as of December 31, 1992, state:

- (a) Article 13 - Per diem and travel expenses within the country should be paid in advance.
- (b) Article 15 - The officer or employee that concludes a trip and returns to his office or department will have three business days for turning in to the corresponding Administrative Section a report of the trip and a liquidation of per diem in the respective format.

In addition, A.I.D. regulations require that per diem costs should be properly supported.

**Cause:**

Project management did not opportunely designate the responsibility for adequately supervising the compliance with per diem regulations.

**Effect:**

During our audit we noted that, of the total per diem disbursements amounting to L567,290 as of December 31, 1992, there are per diem transactions amounting to L260,273 which were not sustained by trip reports and expense liquidations. Also, those expenses showed excess payments for the days authorized. This matter is also an instance of noncompliance with Honduran laws.

**Recommendation:**

Project Implementation Unit management should establish the necessary procedures to accomplish the current per diem laws and regulations.

5. The Credit Department did not Ensure that the Banks Participating in the Program Were Complying with A.I.D. Regulations for Granting Credit, which Caused Significant Instances of Noncompliance

**Condition:**

Our review of the loans granted to the beneficiaries of the project revealed the following instances of noncompliance with the agreement terms and with the regulations established for the operations of the credit component:

- (a) Loans were granted to some directors of the banks participating actively in the credit component of the project which is forbidden by the Chapter I, article 5, parenthesis c, of the credit regulations. For example: a loan was granted to Mr. Manuel Venancio Bueso, Manager of "Banco de Occidente" to be used in the execution of the projects detailed in the following page:

<u>Project</u>	<u>Amount</u>
El Capulin	L197,600
El Planón de Caña Brava	<u>68,300</u>
	<u>L265,900</u>

(b) Credits were authorized over the limits established in the Annex I, Section B.1.a. of the Amplified Project Description. The examples noted as follow:

<u>Project</u>	<u>Date</u>	<u>Disbursement Amount</u>	<u>Established Limit</u>	<u>Questioned Amount</u>	<u>Bank</u>
Hondex, S. A.	Dec/15/89	L1,162,200	L 700,000	L 462,200	Trabajadores
Santa Rosa	Jan/08/90	1,144,000	700,000	444,000	Trabajadores
Finca Mónica	Mar/21/91	974,700	700,000	274,700	Del Pais
Finca Santa Inés	Jun/06/91	1,000,000	700,000	300,000	Sogerin
La Esperanza	Jun/08/91	1,000,000	700,000	300,000	Sogerin
Finca Santa Inés (Ext)	Mar/06/92	<u>1,000,000</u>	<u>700,000</u>	<u>300,000</u>	Sogerin
		<u>L6,280,900</u>	<u>L4,200,000</u>	<u>L2,080,900</u>	

(c) More than two projects were financed for a single beneficiary contrary to what is established in the chapter II, article 11 of the credit regulations. Therefore, the amounts disbursed exceeded the limits established. The cases noted as follow:

<u>Beneficiary</u>	<u>Project</u>	<u>Amount</u>	<u>Established Limit</u>	<u>Questioned Amount</u>
Cultivos Palmerola	Verduras y Flores	L 124,700		
	Los Palillos	281,500		
	Rincón No 1	744,900		
	Rincón No 2	475,900		
		<u>L1,627,000</u>	<u>L1,400,000</u>	<u>L 227,000</u>
Armida de Villela y Miguel Villela	Finca Ticamaya	L 700,000		
	San José Agroind.	700,000		
	Flor del Valle			
	Agroindustrial	700,000		
		<u>L2,100,000</u>	<u>L1,400,000</u>	<u>L 700,000</u>

(d) The funds of the approved loans were partially used in activities different from those of the project. For example: A loan of L78,800 was approved to project "El Pacón", however, the supervisor of this project informed us that the investment made in the projects activities was just L58,424. The remaining amount of L20,376 was applied to activities outside the project.

#### Criteria:

Chapter I, article 5, parenthesis c; chapter II, article 11, and chapter VII, article 31, parenthesis h) iv) of the regulations for credit operations of the loan and grant agreement and the Annex I, Section B.1.a. of the Amplified Project Description establish prohibitions about the eligibility and destination of the projects funds.

**Cause:**

Lack of an adequate internal control structure for the review and authorization of the loans transacted by the banks participating in the project.

**Effect:**

The questioned costs arising from the situations described above total L3,294,176. Also there is a lack of assurance that program funds were used for authorized purposes.

**Recommendation:**

Project Implementation Unit management should create an adequate administrative structure and implementing written procedures to supervise the banks participating observance of the project's credit regulations and dispositions.

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
USAID/HONDURAS PROJECT No. 522-0268  
MANAGED BY THE PROJECT IMPLEMENTATION UNIT  
OF THE NATIONAL DIRECTORATE OF WATER RESOURCES  
FOR THE PERIOD SEPTEMBER 1, 1988  
TO DECEMBER 31, 1992

INTERNAL CONTROL STRUCTURE

RECOMMENDATION 1:

The Project should establish manuals of control procedures necessary to reinforce its internal control structure and it should also establish better mechanisms for its supervision and maintenance at optimum levels.

RECOMMENDATION 2:

Project management should establish the accounting systems and procedures for conducting monthly reconciliations of funds received, disbursed and available from all sources, and assign responsibility for the timely review of these reconciliations.

COMPLIANCE WITH AGREEMENT TERMS AND APPLICABLE LAWS AND REGULATIONS

RECOMMENDATION 1:

Project management should establish specific procedures for the processing only transactions that are properly documented.

RECOMMENDATION 2:

Project management should establish an adequate internal control structure for requisition, bidding, and receiving of the repairs and maintenance services of the vehicles in accordance with the regulations for procurement services established in the grant agreement and Project Implementation Letters.

RECOMMENDATION 3:

Project management should: (1) Immediately develop and implement effective procedures related procurement, control, and custody of inventory; and (2) require the execution of a complete physical inventory as soon as possible. In addition, a complete reconstruction of inventory transactions and record is needed to establish theoretical quantities and amounts with which the results of the physical inventories can be compared to further establish and investigate shortage.

RECOMMENDATION 4:

Project management should establish the necessary procedures to accomplish the current per diem laws and regulations.

RECOMMENDATION 5:

Project management should create an adequate administrative structure and implementing written procedures to supervise the observance of the A.I.D. credit regulations and dispositions by the banks participating in the Project.

AUDIT OF THE IRRIGATION DEVELOPMENT PROJECT  
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MANAGEMENT COMMENTS

Because all personnel from the project's previous management stopped working for the institution due to changes in the government from the month of January of 1994, and even though the present project management agreed verbally with the contents of this report, it was decided not to issue any written comments; for this reason no management comments exist regarding this report.