

Norad project number: GLO-01/400-264 (NCA Project ID 10374)
Name of your Organisation: Norwegian Church Aid
Local Partner(s): Salvadoran Lutheran Synod (SLS)

ABOUT THE EVALUATION

Evaluation year: 2004

Conducted by: Amory Gonzalez, CPA (Guatemala)

Country: El Salvador

Region: Central America

Theme/DAC sector: 150 Government and Civil Society / 50 Strengthening Civil Society

SUMMARY OF THE EVALUATION

Title of Evaluation Report:

External Financial Evaluation of SLS, El Salvador

Background:

In 2003 a comprehensive organisational evaluation of SLS was done. The evaluation revealed a need for a more thorough evaluation of the area of financial management.

Purpose/ Objective:

To evaluate the current financial situation of SLS, as well as recommend measures to improve the areas under examination, and additionally, to verify the reasonability of the balance sheets and accounting records.

Special requirements:

- To verify compliance, on the part of the institution, with tax and labor laws as well as other requirements applicable to the activities of SLS.
- To evaluate the reliability of the internal control system and its functionality.
- To examine support documentation for cash disbursements and the reasonability of global expenditures.
- To analyze the collection of reported current and past due balances. Investigate reasons for renewal of documents.
- To verify the physical existence and ownership of the assets. Certify that the more important acquisitions have been registered in the name of the organization.
- To exam the procedure for the acquisition of assets and inventory goods.
- To exam insurance policies that protect the assets of the institution.
- To review other matters considered to be of importance to SLS operations.

Methodology:

- Meetings with SLS personnel.
- Evaluation of the internal control system.
- Risk management evaluation.
- Samples of the accounting documents/support documentation.
- Quality assurance of the procedures/documents.

Key Findings:

SLS had deficiencies in the processing of financial information, in internal control system and SLS, also, has failed to comply with some legal obligations, especially those related to the retention of

income tax for the professional and technical services, the retention of social security quotas and expenses that are not supported with legal documentation.

1. Financial Information

We observed the following deficiencies in the processing of financial information.

- A. Delays in the ownership registration of the San Lorenzo land plot, acquired in June 2001, and which has yet to be recorded as an asset of the institution.
- B. Omission of the appraisal of the main land plot on which the headquarters of the SLS is currently located, as well as a record of a mortgage obligation related to said asset.
- C. Bank balances shown on the financial statements, totalling USD3,941 inactive for a number of months, and for which no evidence of ownership was available to us.
- D. Account Receivable with Créditos Fe y Servicios, in the amount of USD45, 341, shown on the financial statements, of which only USD2, 000 is considered collectible.
- E. Accounts Payable in the amount of USD142 651 shown on the financial statements, of which we could not find evidence of the source.
- F. Repeated use of the bank reconciliation's as a tool to verify income receipts, due to the weaknesses of the internal control system, a basic element in the recording and reporting of income receipts.
- G. General lack of formality in the preparation of the financial statements, whose information does not agree with the official figures prepared by the NCA concerning execution of the various projects.

2. The Internal Control System

We found important deficiencies in the internal control system, summarized as follows:

- A. Inadequate procedures for the receipt of income and its application to the auxiliary records of accounts receivable. No auxiliary income correlation records are kept to allow for verification of cash received during the reporting period and there is no verification of the accuracy of the data after processing. The data reported on the auxiliary does not reflect the discounts applied on the payrolls.
- B. Deficiencies in the procedural formality of loans to employees. The contracts do not agree with the figures of the accounting department. The accounting department is not informed in a timely and adequate manner by upper levels, of changes occurring in regards to agreed upon conditions with the credit beneficiaries. Information is changed on magnetic media by verbal instruction, without supporting documentation.
- C. The accountant is the only person privy to the operational structure of the data processing system. No back-ups have been created to support accounting information files outside of the terminal where they are managed, allowing for risk of total loss of the records.
- D. Deficiencies in the control of advances made to employees, and the corresponding retentions recorded on the payroll and the record of modifications to payroll data, and which are carried out by verbal instruction, with no supporting documentation.
- E. Deficiencies in the control of expenses and use of assigned assets belonging to the entity.

3. Compliance with Laws

SLS has failed to comply with some legal obligations, such as the retention of income tax for professional and technical services rendered, retentions of the social security quotas, based on amounts lower than actual wages, and expenses that are not supported with legal documentation, all of which leads us to believe that SLS is not in compliance with laws and applicable requirements.

Recommendations:

SLS has to improve its internal control systems, through the implementation of some mechanisms and instruments to register all the financial movements. Besides that, SLS has to legalize its organisation. Concretized in a long list of specific recommendations.

Comments from Norwegian Church Aid (if any):

SALVADORAN LUTHERAN SINOD

SPECIAL OPERATIONS REVIEW

JULY 2004

SALVADORAN LUTHERAN SINOD
OPERATIONS REPORT
JULY 2004

REF.AG.188-2004

Guatemala , September 29, 2004

To:

Norwegian Church Aid

By Personal Delivery

Dear Sirs:

This letter is intended to submit for your consideration, the results of the special examination we performed of the Salvadoran Lutheran Synod operations, under the following terms:

1. Background Information

Norwegian Church Aid (NCA) is an autonomous, ecumenical, non-profit, international cooperation organization, which supports various poverty relief programs in numerous Latin American countries.

Its operations in El Salvador have been reported for many years through the *Salvadoran Lutheran Synod (SLS)*, a church organization based on Lutheran theology, and which works in various social fields such as Human Rights, Education and Community Health.

2. Purpose of the Examination Service

NCA asked us to perform a special examination of *SLS* operations, to evaluate the current financial situation of the organization, as well as recommend measures to improve the areas under examination, and additionally, to verify the reasonability of the balance sheets and accounting records.

Our work was intended to comply with the following special requirements:

- A. To verify compliance, on the part of the institution, with tax and labor laws as well as other requirements applicable to the activities of *SLS*.
- B. To evaluate the reliability of the internal control system and its functionality.
- C. To examine support documentation for cash disbursements and the reasonability of global expenditures.
- D. To analyze the collection of reported current and past due balances. Investigate reasons for renewal of documents.
- E. To verify the physical existence and ownership of the assets. Certify that the more important acquisitions have been registered in the name of the organization.

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- F. To exam the procedure for the acquisition of assets and inventory goods.
- G. To exam insurance policies that protect the assets of the institution.
- H. To review other matters considered to be of importance to *SLS* operations.

3. Results of the Examination

The results of our examination are summarized as follows:

1. Financial Information

We observed the following deficiencies in the processing of financial information.

- A. Delays in the ownership registration of the San Lorenzo land plot, acquired in June 2001, and which has yet to be recorded as an asset of the institution.
- B. Omission of the appraisal of the main land plot on which the headquarters of the *SLS* is currently located, as well as a record of a mortgage obligation related to said asset.
- C. Bank balances shown on the financial statements, totaling USD3,941, inactive for a number of months, and for which no evidence of ownership was available to us.
- D. Account Receivable with *Créditos Fe y Servicios*, in the amount of USD45,341, shown on the financial statements, of which only USD2,000 is considered collectible.
- E. Accounts Payable in the amount of USD142,651, shown on the financial statements, of which we could not find evidence of the source.
- F. Repeated use of the bank reconciliation's as a tool to verify income receipts, due to the weaknesses of the internal control system, a basic element in the recording and reporting of income receipts.
- G. General lack of formality in the preparation of the financial statements, whose information does not agree with the official figures prepared by the *NCA* concerning execution of the various projects.

2. The Internal Control System

We found important deficiencies in the internal control system, summarized as follows:

- A. Inadequate procedures for the receipt of income and its application to the auxiliary records of accounts receivable. No auxiliary income correlation records are kept to allow for verification of cash received during the reporting period and there is no verification of the accuracy of the data after processing.

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The data reported on the auxiliary does not reflect the discounts applied on the payrolls.

- B. Deficiencies in the procedural formality of loans to employees. The contracts do not agree with the figures of the accounting department. The accounting department is not informed in a timely and adequate manner by upper levels, of changes occurring in regards to agreed upon conditions with the credit beneficiaries. Information is changed on magnetic media by verbal instruction, without supporting documentation.
- C. The accountant is the only person privy to the operational structure of the data processing system. No back-ups have been created to support accounting information files outside of the terminal where they are managed, allowing for risk of total loss of the records.
- D. Deficiencies in the control of advances made to employees, and the corresponding retentions recorded on the payroll and the record of modifications to payroll data, and which are carried out by verbal instruction, with no supporting documentation.
- E. Deficiencies in the control of expenses and use of assigned assets belonging to the entity.

3. Compliance with Laws

SLS has failed to comply with some legal obligations, such as the retention of income tax for professional and technical services rendered, retentions of the social security quotas, based on amounts lower than actual wages, and expenses that are not supported with legal documentation, all of which leads us to believe that *SLS* is not in compliance with laws and applicable requirements.

We encourage you to carefully consider the content of this report and to develop a work plan that defines responsibility assignment and dates for its completion, in order to take the measures needed to bring the risks to a minimum acceptable level.

Sincerely,

AMORY GONZÁLEZ, CPA

Lic. Amory Gonzalez C.

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I BANKS

1. Deficiencies in the preparation of bank reconciliations

Bank reconciliations are not done formally. They are prepared manually without using a pre-designed format. In some cases, they are submitted with erasures and crossed-out data.

They are prepared by the same person who reviews them. They are not signed by the person who prepared them and reviewed them.

Recommendations

SLS must introduce more formality in the process of making bank reconciliations. These must be made by a person other than the general accountant and reviewed by her latter, providing evidence of the review process and authorization of the official format used to prepare those reconciliations.

2. Lack of information on daily availability

No report is written to be able to see the daily availability. This presents the risk of over-drafting some accounts due to inaccuracy in reported balances.

Recommendation

Prepare a daily availability report that will include all the bank the balances and movements of the day, or the week if the volume of transactions is reduced. This report will be used as a third matching element when monthly reconciliations are done.

3. Deficiencies in revenue management

A. A procedure to record institutional revenues is lacking. Bank reconciliations are always used to make corrections and record transactions that had been omitted. There is a risk that some transactions may cease to be reported by the bank and therefore will go undetected by SLS. Some examples are:

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Cuscatlán	301-003633	Jan/04	\$22,177	Not unaccounted
	301-003633	Apr/04	321	Unaccounted remittance
	301-003633	Mar/04	296	Unaccounted remittance
Bco Agrícola	507-0033231	Mar/04	7,300	Savings account transfer

A US\$25 deposit was detected in January /04 that could not be identified. These funds were registered as an unaccounted remittance” to have the accounting match the banks.

- B. A sequential file of cash receipts issued is not available. The only copy available is attached to the deposit voucher. This makes it impossible to make subsequent reviews of receipts issued during one period.
- Procedures have not been established to record revenue-related transactions. A list of transactions is not produced after imputing in the system and therefore no review of them is made. There is a risk of inaccuracies in recording transactions, without them being detected.
 - A deposit form is filled for every receipt issued. This is unnecessary work. A global report to show the revenues of the day is not produced.

Recommendation

We propose the following in order to improve revenue controls:

- A. Define a policy to issue cash receipts only when a payment is made, as follows:

Original	Client
Copy	Accounting
Copy	Sequential

- B. Every direction unit must report to accounting all bank-related transactions such as transfers, grants or others.

A cash receipt will not be issued.

- C. The person in charge of operating revenues in the auxiliary system needs to obtain from the system a revenue report after revenues have been operated in the system and transfer them to the accountant for review and approval.

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II. ACCOUNTS RECEIVABLE

4. Deficiencies in accounts receivable controls

A. We saw the following cases where information noted in the agreement does not agree with the auxiliary accounts receivable record:

Lot No.	Contract	Auxiliary record
60-58	USD 665.60	879.88
6-56	USD 665.60	879.88
7-83	USD 597.02	685.71

B. In several cases, the files do not have a notice of the withdraw done. In some cases, there are original records and in other cases there are copies, which is an indication of lack of consistency in the application of procedures.

C. We found the following cases of discounts made in payrolls that are not credited to the current account:

January 2004.

Aracely Ventura	37.50
Guadalupe Cortez	29.22
Martir Vigil	34.95
Vilma E. Rodríguez	<u>31.23</u>
Total	<u>132.90</u>

Febrero 2004

Araceli Ventura	37.50
Guadalupe Cortez	29.22
Vilma Rodríguez	<u>31.23</u>
Total	<u>97.95</u>

In some cases, these discounts are applied to the following month or are accrued to be applied in one single month. This is indicative that there is no matching procedure established to verify the proper registration of revenues reported during the month against the auxiliary registry. We noted the following procedure for the month of January 04:

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Income according to accounting	886
Payroll discounts	474
Total revenues	1,360
Revenues according to record	<u>1,295</u>
Difference	65

The income reported by the accounting system correspond to a net balance that includes a check for US\$90 reimbursed to María Edith Villalobos. This operation is not reported in the auxiliary record, where the parcel of land is shown as assigned to José Romel Ventura Abarca.

In the case of Ana Ruth López Castro, she paid two installments during January/04 but only one was recorded. The adjustment was done in February/04.

We see the following differences for February 04:

Revenues according to accounting	2,040
Revenues according to auxiliary report	<u>2,438</u>
Difference	<u>398</u>

- D. Polígono 2-7 Milagro Esperanza Rivas. The suspension of the service and attachment of the house was reported on 30 April 04. At the time of our visit, accounting was unaware of this situation.
- E. A code has not been assigned to manage files, and therefore it is hard to register data and the possibility of mistakes when reporting transactions increases. The reference is done with the following problems:
- By user name and this is not practical, because the piece of land is shown in the name of two or more persons.
 - By lot number and this is not practical because the pieces of land have sometimes changed owners.
- F. We see the following deficiencies in the mutual contracts done for San Lorenzo: Cecilia Osiris Pineda. The amount to be paid is US\$800, but this does not agree with the US\$900 listed in the document. The document is not signed by a lawyer and does not indicate the area of the

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lot that is the object of the contract, and therefore, there is not sufficient guarantee in the event of possible conflict.

- G. Eva Cecilia Alfaro. Discounts are being made for US\$61.80 in the payroll, but according to the agreement document, US\$55.43 should be discounted. According to the auxiliary registry, this person has been assigned lot number 2-23 but according to the contract, she was assigned lot 1-23.
- H. According to the auxiliary registry, polygon 4-34 is assigned to two different accounts: Rosa Vilma Escobar González and Julio Gálvez, who has been paying these last months. The mutual contract of July /02 shows that this lot as assigned to Erick Douglas Paredes Campos.
- I. We found the following cases of debt recognition by employees, but they have no dates: Concepción Marina Ángel Vanegas and Guadalupe del Rosario Cortez de Hueso.
- J. There is no reliable information on the portfolio's overdue. We were not able to determine the number of late payments in each project. An official report is not prepared, and no measures are adopted. The information on late payments is discussed and commented on verbally.

Recommendation

SLS management must improve its accounts receivable controls, and for this, the following recommendations should be taken into account:

- A. Review the files of each credit user and make sure that they include the following information:
 - Loan application by applicant
 - Notice of approval or loan granted
 - Contract duly signed by the parties

The data in the agreement need to be confirmed prior to having the parties sign, in order to make sure that they are accurate. A copy of the agreement should be given to the borrower for subsequent validation.

Each user will have a code assigned to him/her to make it easier to search and monitor the file.

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- B. A copy of the agreement will be send to the accounting department to register the data in the auxiliary credit system that will be modified only on the basis of the following documents:

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- Copy of the original agreement
- Income receipts
- Voucher checks
- Report of discounts made on payrolls
- Notice of write-down

No transaction will be recorded in the auxiliary record system unless it is supported with a document.

- C. Fee charges will come from two sources: recoveries in payrolls and cash receipts.

For the case of recoveries in payrolls, a copy of it will be sent to accounting for it to apply individual withholdings and verify that the total amounts applied during the month agree.

For the case of cash receipts, a receipt will be issued every time there is cash revenue. A copy will be sent to accounting for recording. A summary of revenues will be done at the end of the month, when verification will be made to make sure that the recovery in each project agrees with the total sums operated in the auxiliary system.

- D. Management should report in a timely fashion to accounting of everything having to do with loans, such as: advance payments, due dates of loans, changes of credit users and others.

5. Deficiencies in the auxiliary portfolio system

The application for portfolio control consists of an electronic spreadsheet file where we see the following:

- A) It is a separate system that is not linked to accounting. This causes duplicity in the registration of transactions.
- B) Only current balances are kept. There is no history of the transactions related to each account, and therefore it is not possible to prepare statements.
- C) Changes are made to the system based on verbal instructions without formal requirements. This presents the risk that the balances reported by the system may be altered without authorization. We see the following cases where the balances reported do not agree:

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	<u>At December 31</u>	
	<u>2003</u>	<u>2004</u>
Julio César Alemán	574	450
José Alejandro Cáliz	786	686
Francisco Benavides	523	450
Ana Emely Chávez	457	800

Additionally, there is no procedure to make it possible to integrate the balances of each portfolio on a monthly basis. This increases the risk that transactions that have not been authorized may be registered in the system without the possibility of detecting them.

- D) In the San Lorenzo portfolio we see the following cases reported with negative balances:

Norma Castillo de Menjivar	USD 59
Eva Cecilia Alfaro	43

This is an indication of the poor application of fees to the wrong account.

Recommendation

SLS needs to implement a system to integrate the auxiliary portfolio control system to the accounting system, in such a way that each transaction is recorded simultaneously in both. On a monthly basis, it is necessary to verify that the balances reported by both sources agree, and must clean them up and investigate them in the case of differences found. It should have the capacity to keep a historical record of transactions related to each account, in such a way that, based on the initial balance, it will be possible to identify every transactions carried out to the final balance, and vice versa.

- A. Eliminate the practice of requesting changes to balances reported by credit users without documents. It is necessary to issue a debit note or credit note, as the case may be, with the sequential control of each one and with evidence of authorization, in such a way that every transaction is properly documented.

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III. PAYROLL

6. Deficiencies in the payment of worker severance

Severance has been paid without preparing a formal settlement account to show the date when the worker joined the organization, when he/she left, and the detail of the benefits included in the settlement. There is no evidence of verification of the calculation done to pay the settlement, or evidence of authorization on the part of the head of the department. Some examples are:

Felipe Hernández Rosales	USD 375.
Ana Patricia Carranza	321

Recommendations

Instruct the accounting department for worker settlement to be prepared with every formality taken into account, including:

- Full name of the employee
- Date when the working relationship started and when it ended
- Calculation of the proportional days applied to each benefit and the detail of the calculations made.
- Evidence of reviews and authorization by the appropriate department head.
- Full and final quitclaim signed by the employee and certified by a lawyer.

7. Undocumented changes in payrolls

Changes in payrolls are made on the basis of verbal requests without documentation of the origin of said changes and without the recording of a historical file of the changes made to each payroll. This presents the risk of unauthorized changes.

Recommendation:

Discontinue the practice of making changes to payrolls based on verbal requests. Department heads must issue instructions in writing to the accounting department to record the changes in payroll. Accounting should prepare a summary of the new employees, employees who have left the organization and the changes for each period, and should leave them attached to the payroll file, as evidence that will be the basis to authorize it.

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8. Lack of personnel files

There are no personnel files available. Formal files have not been opened to record all the information related with employees from the beginning of the working relationship to its end. The company has not drafted written contracts. This presents the risk of complaints in the case of labor conflicts.

Recommendation

Go through the necessary procedures to issue work contracts as a priority.

Implement individual files for each employee, including at least:

- Work application.
- Work contract.
- Social security suspensions.
- Notice of temporary suspension of the work relationship.
- Information about changes.
- Notice of salary increases.
- Resignation letter.
- Final quitclaim.

9. Payments are not made every fifteen days

Due to problems of liquidity, SLS has not established the policy to make salary advances every fifteen days to all its employees. This means that the employees are constantly requesting advances and it becomes necessary to keep track of these advances. This is poor practice because of the risk of mistakes at the time when the payment of the payroll needs to be made. We see a delay in the payment of the payroll in the following cases:

Salary month	Paid on
January/03	27/March/03
May/03	11/July/03
June/03	22/July/03
September/03	03/November/03

In the case of Mr. Ricardo Cornejo, he was given a US\$100 advance, and only US\$50 have been recovered. This is an indication of the problems brought about by the need to keep individual control of advances made.

Recommendation:

Establish a practice whereby all the employees, without exception, receive an advance, in order to apply discounts in general at the time when the payroll

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needs to be settled. Make no exceptions in the payment of payroll advances. Project cash flows in a timely fashion in order to avoid delays in paying salaries.

10. Unauthorized internal work regulations.

The internal work regulations have not been authorized by the Ministry of Labor. Article 302 of the Labor Code provides that the regulations must be adopted by the Director of Labor relations for it to be valid.

Recommendation:

Go through the proper procedure to have it duly authorized by the authorities.

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IV. FIXED ASSETS

11. Deficiencies in fixed asset control

There is no fixed asset integration with detailed information on the date of acquisition, original cost, accrued depreciation and value in the books at present. Even when most of the assets of the organization are already depreciated, it is important to have the integration of the fixed assets. On the other hand, responsibility cards are not available that would be useful to identify the location of the assets that are the property of SLS. The risk is that some assets could be withdrawn without authorization and without being detected.

Recommendation:

To make an inventory of the fixed assets and assign them according to responsibility cards, that should be signed by the employees as a proof of acceptance of having received the asset. Implement auxiliary registration systems to keep a record of the accrued depreciations applied to each asset acquired.

12. Mistaken accounting of a fixed asset that was sold

Real estate was sold to Gilma Guadalupe Iraheta Romero pursuant to document No. 15 of December 5th, 2003. The profits from the sale of this asset were mistakenly recorded at that time.

Recommendation:

To record the following items to revert and correct the effect of the previous mistake:

A + B + C

Item line suggested by Audit

1.		
1230104	Buildings and facilities	68,976.00
1210102	To: Buildings and facilities	24,146.00
31101	World Lutheran Federation	<u>44,830.00</u>
The original item line affected by the discount Of the asset is reversed		<u>68,976.00</u> <u>68,976.00</u>

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2.

31201	Previous periods	68,976.00	
31201	Previous periods	12,024.00	
111020102	To: Banco Cuscatlán General acct.		81,000.00
The original item line is reversed and debited to Profits of 2003		<u>81,000.00</u>	<u>81,000.00</u>

3.

111020102	Banco Cuscatlán General Acct.	81,000.00	
1230104	Accrued Dep. Buildings and facilities	24,146.00	
3120101	World Lutheran Federation		36,170.00
1210102	Building and facilities		<u>68,976.00</u>
Item suggested by audit to record		<u>105,146.00</u>	<u>105,146.00</u>

The reduction of the asset, and the profits are recorded in the 2003 period.

13. Asset and liability omitted in the purchase-sale of a lot

The obligation for the purchase-sale of the lot of land currently being used by the headquarters of SLN is not registered. Document number one of the first book of 2001 declare that there is an open mortgage for an amount of up to US\$636,097.89, over which the donor is making amortizations on his own behalf. The piece of land has been transferred in the name of SLS for a purchase price of 4,000,000 Salvadorian colones (US\$457,143) as provided in the same documents. From additional information obtained we understand that this transaction demanded an additional payment in dollars that is not reflected in this transaction or in the financial statements.

Recommendation:

SLS needs to reverse the item lines recorded to date with regard to this transaction and register the following item lines to properly record it:

- 1) Debit Buildings and facilities
Credit Mortgages payable
Credit Donated capital

in order to register the amount actually paid for the acquisition of the building.

- 2) Debit Results from previous periods
Credit Accrued depreciation, buildings and facilities

in order to fix the accrued depreciation from the date when the transaction was registered.

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- 3) Debit Mortgages payable
Credit Donated capital

In order to register this last item line, SLS needs to confirm the accrued balance of the mortgage to date, in order to determine the accrued amount through the difference that should be registered as a donation.

14. Delays in the registration of property

- The dismembering of the San Lorenzo lot has not been registered in the Real Estate and Mortgage Registry. As the lawyer indicated, this is due to the fact that problems have been detected in the original measurement provided by the technician, where there is a mismatch.
- The document signed by notary Ramón Quinteros Monroy in Book No. 3, number 121 of 2001 is deficient, since there was a previous mortgage on the property that was dismembered. The creditor indicates that it has received capital installments and interest but that there is no indication that the real estate acquired by the Salvadoran Lutheran Synod are free from all lien. According to the lawyer, this was only a verbal indication. To this date, the specific mortgage release has not been signed. Risk of loss for SLS.

Recommendation:

SLS management must urgently follow up on the dismembering procedure in the property registry to make sure that it is registered in its name.

At the same time, it should take action to clarify the terms under which the land acquired by SLS is purchased and to make sure that they are free from all lien.

V. EXPENSES

15. Deficiencies in the hiring of consulting services

In February 2004, SLS hired the services of Master Consultoría S. A. De C. V. for the institutional strengthening of the organization. The agreement was for USD75,000.

In the hiring process of this service, we noted the following deficiencies:

- A. Terms of reference were not written down to define the scope of the work, the prior experience required by consultants and parameters to grade proposals.

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- B. The proposal that was accepted does not include information about prior experience in similar consulting work or a resume of the persons charged with the responsibility of providing the service.
- C. The proposal was submitted in a simple sheet of paper rather than on letterhead. It does not specify clearly what will be the end products of the consulting service.
- D. The contract does not indicate if the VAT and other expenses are included in the contracted fees. The fees named in the proposal (USD116,000) do not agree with the amount contracted.

Recommendation

For the case of services hired for a significant amount like this case, SLS management needs to make sure that it fulfills a number of formalities that guarantee transparency in the execution of the process and leave no room for doubt regarding the scope of the work, the amount of the fees agreed to, and in general, the grading process carried out to select the firm hired.

16. Direct delivery of materials

At times, material is acquired for projects which is delivered directly to the works without going through a formal process of verification of the material purchased against that which is actually received.

Recommendation:

SLS needs to make sure that when material is delivered directly to the works, a person is designated to verify that the material is received according to quality and quantity specifications agreed to for the purchase.

17. Deficiencies in settling expenses

In the case of advances given for work commissions, a formal settlement is not done of the expenses. The process of authorization is done only when the advance is given and not at the moment when the expenses are settled. Example: Check No. 4281: Vilma Esperanza Rodríguez USD 100. An expense settlement for USD107.51 was submitted, with no evidence of a formal settlement of said expenses. It does not agree with the advance made for this expense.

Ch. No. 4277 for fuel advance: USD 60. The receipts submitted are for USD56.59. No

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Recommendation:

The beneficiary of the advance must submit a formal list of the expenses made, must attach support documents and return the balance. It is then necessary to request that the appropriate department review these documents to authorize the expense through his/her signature.

18. Lack of mileage control

Mileage reports are not filled out to report on the use of the vehicles that are owned by SLS. The reasonableness of fuel consumption in the vehicles owned by SLS is not measured.

Recommendation:

SLS must implement daily mileage control of the use of its vehicles. This control should indicate the mileage when the vehicle is received and when it is returned with an explanation of the expenses incurred with the vehicle. Said report needs to be reviewed and approved by an authorized official.

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VI. ACCOUNTING SYSTEM

19. Deficiencies in the accounting system

Regarding the accounting system, we note the following deficiencies:

- A. Concentration of functions. The accounting system is managed only by the general accountant assigned to carry out that role. No other person in the organization knows how to access the system. There are no documents or instructions that explain how to access it. This poses a risk that if the accountant is absent, due to illness, SLS would face problems to access accounting information.
- B. Journal entries are made with no formalities. Several journal entries have been made in the system with the following problems:
- There is no evidence of the review and approval of the entries
 - There is no explanation of the origin and nature of the entries
 - There are no support documents to justify them. There is no official accounting entry file. This weakens the reliability of the accounting system. Some examples are:
 - Account No. 301-001565 Cuscatlán. Unidentified difference for US27.84, that was corrected on line without a journal entry.
 - Payroll provision entry for May 04, prepared without reviewing and approval.
- C. Lack of back-up copies. Back-up copies of the files that have the accounting information have not been done. The copies made are in the same computer. The maintenance given to the system is deficient. Under these circumstances, there is a high risk that the hard disk of the computer may suffer damage and the historical accounting information could not be recovered.
- D. There is no established procedure to record bank transactions. The accounting system is not the basis to detect important differences. Reconciliations are used to make accounting adjustments and this means that important transactions are not included in the reconciliation. Some examples are:

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507-0033231	Mar/04	US 7,300	Savings account transfer
507-0033231	Mar/04	US 330	Unaccounted for checks

- E. A culture has not been established to prepare financial statements formally every month. At the closing of the period there is not an official set of financial statements formally prepared by management. Financial statements submitted by external auditors do not include Cash Flow Statements or Capital Status Statements.
- F. There is no separate auxiliary system to control advances and loans to employees. A detail account is opened for each employee in the accounting, and therefore this loses its role as a control point.
- G. Checks are cut manually and later input into the system. There is no review done of the checks after they have been input into the system. This means that sometimes, mistakes are made in recording them.
- H. A procedure has not been established to review the transactions that are input into the system. Under these circumstances, the risk is that some transactions may be skipped when they are input into the system or applied to the wrong account and that would go undetected.

Recommendation

SLS should adopt the following measures to improve upon the accounting system function:

- a. Give the accounting assistant the responsibility to record transactions in the system. The accountant must supervise the work done by the assistant and produce evidence of the review process in the documents prepared by the system after they have been recorded. The accountant needs to prepare instructions to explain the way the system is used and train the assistant to use it.
- b. The accountant needs to make sure that she formally prepares and documents every journal entry recorded into the system. These needs to be prepared by the assistant and reviewed by the accountant after they are recorded into the system. It is necessary to organize a correlative file of journal entries, to make consultation easier.
- c. It is necessary to establish procedures for revenues to be registered on a daily basis. This needs to be done from sequential cash receipts and the practice needs to be established for every revenue to be documented with a

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receipt. Senior management needs to transfer information to accounting about every transfer received in such a way that, when the reconciliation is done at the end of the month, differences are very small.

- d. SLS must prepare monthly financial statements and use said tool as part of the decision-making process.
- e. Issue instructions for the checks to be made through the system, for which voucher photocopies may be used which will be processed together with the original check.
- f. The accountant needs to use separate auxiliary records to control advances for employees. This auxiliary system may be handled through electronic spreadsheets and be reconciled on a monthly basis with the balances reported by accounting.
- g. It is urgently necessary to make a back-up copy of all the accounting files. This copy needs to be kept outside of the accounting office.

20. Unsettled accounting balances

- A. Accounts receivable reports USD 45,341 for Créditos Fe y Servicios. Of these, an estimated US 2,000 are considered collectable. The difference of US\$43,341 needs to be written-off from the financial statements.
- B. Several balances are reported that have had no movement for the last several months. We did not obtain information about the real existence of said balances:

▪ Cash		\$585
▪ Bco. Cuscatlán	005-301-01543	40
▪ Bco. Cuscatlán	005-301-03655	197
▪ Bco. Cuscatlán	005-301-08294	251
▪ BAC	102-2001175	563
▪ Bco. Cuscatlán	301-0003	16
▪ BFA	100-152-66124	671
▪ DAC	502-05691-6	655
▪ Bco. Cuscatlán	507-003323-1	944
▪ BAC	102-174485	<u>19</u>
	TOTAL	3,941

An account statement regarding those balances has not been received in the last few months, and therefore we were not able to verify their accuracy.

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It is necessary to research and confirm the origin of previous balances and write them off from the accounting system if inaccuracies are found.

21. Deficiencies in the preparation of financial statements

At December 31, 03 we find the following cases where balances reported to Norwegian Church Aid disagree with accounting balances:

- A. Community health
 - Natural medicine - training
 - Medical care
 - Visual health campaign

- B. Promotion and organization
 - Environmental sanitation
 - Reproductive health - promotion
 - Integral development - promotion
 - Fe y Vida. Occupational therapy

All these item lines show the same figure: USD 528. We believe that the information reported for each category should agree with the figures reported by accounting. There is a risk of making mistakes in the preparation of this information.

On the other hand, the accounting classification of expenses does not agree with budget execution. There is no evidence of the reclassification done for the purposes of reporting to Norwegian Church Aid– NCA. Therefore, we were unable to verify the budget execution against authorized categories.

Recommendation

SLS needs to reconcile all the information provided to donors against its accounting records in order to guarantee the reliability of the information given to third parties.

Accounting procedures need to be designed in a way that they correspond with the structure of the information given to third parties.

22. Deficiencies in the preparation of financial statements

Financial statements are not done. These are prepared only upon closing the period and include several item lines that have not been settled. An auditor is hired every year to go over the financial statements. However, the financial

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statements at December 31, 2003 do not include the Cash Flow Statement and the Capital Status Statement, and this was not reported by the auditor. This is indication that the financial statement preparation process is not receiving the attention that it needs.

Recommendation:

SLS needs to make sure that monthly financial statements are produced in order to reflect the actual financial status of the organization in a timely fashion. When external auditor services are hired, it needs to make sure that it hires professionals who properly apply the general auditing accepted standards.

23. Lack of accounting policies

There are no procedure manuals to define the accounting policies adopted by the organization. Financial statements at December 31, 2003 do not define the policies adopted by the organization in relation with the management of revenues and expenses, which is essential in order to be able to determine the results of the fiscal year.

Recommendation:

SLS needs to issue official accounting policies, in order to promote the preparation of financial statements on a uniform and reliable basis.

24. Accounts payable from previous years with no activity

Accounts payable reflects the following balances that have had no activity during the last year:

Decanato de Munich	US 9,016
Fundación Vamos	19,990
Fe y Servicio Program	49,125
Unidentified funds	64,520
Total	USD 142,651

These accounts show no activity for the last year.

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Recommendation:

In the case of these accounts, particularly the unidentified funds for US64,520, management should verify whether those liabilities are accurate or whether they should increase the capital of the organization.

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VII. LAWS AND REGULATIONS

25. Withholding statements that were not submitted

The withheld tax (F-14) for payments made to suppliers was not sent to the tax authority during the months of January, February and May. Article 62 of the Law provides for the obligation to transfer those withholding on a monthly basis within the ten days following the month. There is a risk of fines if a review is conducted.

In the case of revenues, SLS has not submitted a statement during the months from January to May 2004 and for 2003. Article 91 provides for the obligation to meet this requirement even if it does not lead to the payment of taxes. There is a risk of fines for non-compliance with these obligations.

Recommendation

SLS needs to adopt measures to meet its obligation to submit the declarations that it has skipped and make sure that all applicable requirements are followed.

26. Expenses that are not supported with formal documents

Some expenses are not backed with legal documents to properly support the expense. Article 139 of the Tax Code provides that accounting entries need to have documents to be able to determine the origin of operations. Some examples are:

<u>TR No.</u>	<u>Ch. No.</u>	<u>Concept</u>	<u>Amount</u>
76	399	The purchase of construction materials	USD 7,276
65	296	Teaching material	496
65	295	Teaching material	383
38	4580	Vehicle repairs	300

Recommendation

It is necessary to issue instructions for every expense to be backed with legal documents (end consumer invoices) or with original signed receipts.

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27. Withholdings for professional services not made

In some cases, professional and technical services have been contracted, but the 10% withholding provided for by Article 156 of the Tax Code as an advance for the income tax, has not been made. Some examples are:

TR No.	Ch. No.	Concept	Amount
69	511	Computer maintenance	165
22	4520	Protocol service, 3 months	411
38	4580	Vehicle repairs	300

Recommendation

It is necessary to issue instructions to the accounting department to make the proper withholding in every professional and technical contract and to make sure that all requirements applicable to SLS activities are met.

28. Differences in social security withholdings

The Pension Fund Law and Social Security withholdings are calculated on a basis lower than the actual salary earned. There are certain cases where no withholding was made. Some examples are:

Employee name	Monthly salary	SLS	Audit	Difference
Aracely Ventura	628.57	8.57	18.86	10.29
Guadalupe de Hueso	800.00	10.29	20.57	10.28
Eva Cecilia Alfaro	857.14	10.29	20.57	10.28
Vilma E. Rodríguez	800.00	----	20.57	20.57

Article 19 of the Retirement Savings System Law provides that fees must be paid by the employer on the basis of the actual salary. Article 33 of the Social Security provides that the employer is liable in the event of not withholding and transferring these fees.

Recommendation

SLS needs to review the fees paid to the Pension Fund and to the Social Security System and make sure that they are paid on the basis of actual salaries. Make a retrospective review of unpaid fees and correct these payments in order to make sure that it is in compliance.