



**Inter-American Institute for  
Global Change Research - IAI**

Management letter



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To  
Mr. Adrian Fernandez  
Chair of the Executive Council  
Inter-American Institute for Global Change Research - IAI

August 11, 2004

Dear Sirs,

Whilst our responsibility is to express an opinion on the said financial statements, management is responsible for the financial statements and all statements contained therein. Management is also responsible for selecting healthy accounting practices and for the implementation of an internal control structure to maintain the reliability of the financial statements and to provide a reasonable assurance, but not absolute, against the possibility of errors and irregularities occurring that is material in relation to the financial statements.

During our interim work, matters came to our attention related with internal controls or areas where it may be possible to improve the effectiveness of your operations, and we describe these important issues in the attached memorandum.

The scope of our examinations of the internal controls and consequently the opportunity we have to observe weaknesses is affected by our selection of the most effective audit approach. Professional auditing standards do not require us to examine the internal controls beyond the extent necessary to determine the nature, extent and timing of other audit tests, and we consider that we were not commissioned to examine the Institute's internal control structure.

The present results of our verification for your consideration.

Please do not hesitate to contact us should you require further clarifications.

Yours faithfully,

Roberto Vilela Resende  
*Partner*

Cleber de Araujo  
*Manager*

## **1 Core budget - Default**

### ***Observed situation***

The Institute receives contributions from the 19 member countries, of which 3 countries (United States, Brazil and Canada) are responsible for around 80% of the contributions received.

Amongst the other member countries, we found that certain countries are in arrears with the contributions by more than 3 years, as shown below:

<b>Country member</b>	<b>Aging unpaid contributions</b>
Paraguay	7 years
Dominican Republic	6 years
Guatemala	5 years
Peru	5 years
Uruguay	5 years
Venezuela	4 years

### ***Implications or risks to the Institute***

As of June 30, 2004, only 5 of 19 the member countries have fully paid their annual contributions and are not in arrears. To date, despite the default, the Institute is not experiencing financial difficulties in maintaining its activities. However, if the situation persists or increases in the coming years, this could lead to a risk of continuity to the Institute.

### ***Recommendation***

We recommend that management seek alternatives to receive the contributions in arrears, and in this way mitigate possible risks of financial difficulties in maintaining the Institute's business.

### ***Management comments:***

*It is a continuous concern to the Directorate, as well as to the constituent bodies of the IAI, the possible negative impact over the financial sustainability of the institute that that the unpaid contributions may cause. As it is explained in the paragraph "Implications and risks to the Institute" of your memorandum, up to now the IAI has not suffered any financial breakdown as a result of these arrears.*

*An ad-hoc working group composed by members of the EC Bureau was created in order to help the IAI Director to contact those countries with the biggest arrears. Personal and telephone contacts were made by the IAI Director and members of the ad-hoc working group to sensitize the Country Representatives on this issue.*

*Another decision made was that by the end of the first quarter of the fiscal year 2004/2005 all those countries not having yet paid their current contribution will receive a letter with a "gentle reminder" to pay their current contribution and informing the total amount of their arrears (when necessary).*

## **2 Financial and scientific report**

### ***Observed situation***

In the case of long-duration projects such as the Collaborative Research Network (CRN), the contributions are transferred to the Grantee Institutions annually, but to ensure that the Grantee Institutions are able to receive the contributions annually, it is necessary to submit the financial and scientific reports in advance and qualified people should approve these reports.

We verified certain projects to find out whether the projects had the financial and scientific reports properly approved before transferring the annual contribution.  
The projects selected for testing were:

#### **Brian Luckman - CRN 3**

*Financial report* - We found that, in the financial report received, the researcher did not account for US\$ 72,621, and, since the annual contribution was US\$ 149,422, the Institute only passed on the amount of US\$ 76,801, which the researcher accounted for the remainder of the annual contribution will be transferred when the researcher accounts for the outstanding balance.

*Scientific report* - We found that the latest scientific report received is partly for the 2003 period.

#### **O. Sala - CRN 12**

*Financial report* - We found that in the financial report received, the researcher did not account for US\$ 82,061, and, since the annual contribution was US\$ 134,183, the Institute only passed on the amount of US\$ 82,122, which the researcher accounted for; the remainder of the annual contribution will be transferred when the researcher accounts for the outstanding balance.

We also found that, of the total of US\$ 82,122 transferred, US\$ 30,000 was transferred before the Institute had received the financial report. This transfer was made in November 2003.

*Scientific report* - We found that the latest scientific report received is for the 2003 period, dated on September 9, 2003.

#### **P. Cornejo - CRN 38**

This project was canceled due to irregularities found, therefore there is no financial or scientific report for this period. We verified that an amount of US\$ 51,712 has yet to be recovered from the Grantee Institution (CATHALAC) of this project.

#### **M. Mc Clain - CRN 47**

*Financial report* - We found that, in the financial report received, the researcher did not account for US\$ 3,688, and, since the annual contribution was US\$ 136,500, the Institute decided to transfer 80% of the amount payable, US\$ 109,200. The remainder of the annual contribution will be transferred when the researcher accounts for the outstanding balance.

*Scientific report* - We found that the last scientific report was received before the annual contribution was transferred.

**M. Nuñez - CRN 55**

*Financial report* - We found that, in the financial report received, the researcher did not account for US\$ 77,855, and, although the annual contribution was US\$ 156,780, even so the Institute passed on US\$ 146,020. The remainder of the annual contribution will be transferred when the researcher accounts for the outstanding balance.

We also found that, of the total of US\$ 146,020 transferred, US\$ 15,000 was passed on before the Institute had received the financial report. This transfer was made in September 2003.

*Scientific report* - We found that the latest scientific report received is for the 2003 period, dated on July 27, 2003.

**Tim Baumgartner - CRN 62**

*Financial report* - We found that, in the financial report received, the researcher did not account for the US\$ 18,478, but although 100% of the amount was not accounted for, the Institute transferred 100% of the annual contribution payable (US\$ 149,240).

*Scientific report* - We found that the last scientific report was received before the annual contribution was transferred.

***Implications or risks to the Institute***

We found that the rules established by the Institute are not being fully complied by Grantee Institutions, which could lead to delays or irregularities in accounting for the amounts transferred to Grantee Institutions and consequent delays in finalizing the projects.

***Recommendation***

We recommend that the rules should be observed according to the agreements signed between the Institute and the Grantee Institutions to avoid possible problems related with delays or irregularities in accounting for project expenditure.

***Management comments:***

*With reference to the Scientific Reports, as not all the projects started at the same time, not always the period reported matches with the fiscal year when the payment is released. Project payments are not released if the scientific reports are not approved.*

*Starting in fiscal year 2003/2004 scheduled payments for the CRN program are released only after the financial report has been reviewed and approved and based on cash needs, provided that the scientific report has been approved. This means that if the project has outstanding advances not reported, these advances will be deducted from the next scheduled payment.*

*Once all the projects have submitted their latest financial report and these reports are analyzed, the advances not reported will be controlled within the IAI accounting system. Up to now, this control was being done in the spreadsheet where the project's financial report is analyzed. This will also allow IAI to recognize the expenses of each project proportionally to the development of the research activity instead of considering the full advance as an expense.*

*As of June 30, 2004 seven reports have been analyzed and we expect to have all the remaining reports analyzed and approved by the end of this calendar year.*

### **3 Financial and scientific reports - Flow of approvals**

#### ***Observed situation***

We found that the scientific reports do not show evidence of reviews or approvals by the scientific director.

In the case of the financial reports, the financial director did not demonstrate his review on the report itself, but in a separate memorandum, which informs the result of the review of the financial report. We also found that the presentation of supporting documents for the expenditure presented in the accounts rendered spreadsheet is not mandatory.

#### ***Implications or risks to the Institute***

Lack of evidence of approval of the scientific reports and the possibility of releasing the annual contributions without the necessary review by the scientific director.

The risk related with the lack of formal approval of the financial report and release of the annual contribution without the researcher having accounted for 100% of the amount advanced in the previous period and the use of the annual contributions for expenses unrelated with the project.

#### ***Recommendation***

We recommend that the Institute should establish a flow of approvals of the scientific and financial reports until the annual payments are made. The review of the report should be formalized in formal documentation by scientific and financial management separately to support the payment to the Grantee Institutions.

We also recommend that the accounts rendered should be accompanied by supporting documents for the expenses informed.

#### ***Management comments:***

*Under the present procedures, the financial reports received are reviewed by the Administrative and Financial Officer who issues a memorandum with comments and a recommendation for payment. This memorandum is issued once the financial report received has been approved.*

*At the time a new project payment is requested, it is necessary that both scientific and financial reports be approved. The Scientific Officer signs the Requisition for Payment form in the field: "Authorized by" as a proof that the scientific report has been reviewed and approved.*

*We understand that this process can be improved, thus a form has been developed ("Checklist for Incoming Reports") that will be used to check the compliance of the report received (scientific or financial) with the established forms. The reports will not be reviewed until all requisites are fulfilled.*

*When the reports are approved, the responsible officer will sign and date the report with the accompanying statement: "REPORT APPROVED DATE: --/--/--".*

*With Reference to the recommendation to request copies of the supporting documents of the reported expenses, for practical reasons, we are not in a position to satisfy this request. When the financial reports are reviewed, the Administrative and Financial Officer can request any necessary additional information including copies of supporting documents for reported expenses. If a serious problem is detected, there is also the possibility to perform a site visit or to hire external auditors to review the documentation and the expenses of the project.*

*For future long-term grants, in order to reduce the risks of receiving incorrect reports, the IAI will assess the administrative and financial capacities of the new grantees previous to the signature of the contribution agreement. The schedule of reports and payments for the project will be adjusted according to the level of risk assessed.*

*Another control for the long-term grants will be the requirement of an external audit review of the financial statement as of the end of the second year. If important weaknesses are detected, the grantee will have a specific term to solve the problems.*

## **4 Contracts with Grantee Institutions**

### ***Situation observed***

In relation to the contracts between the Institute and the Grantee Institutions, we can highlight the following weaknesses identified:

- In the contracts it is not clearly stated how the Grantee Institutions should render accounts and which documents are necessary for this purpose;
- The deadline within which the Grantee Institutions should account for the advances received from the Institute;
- The types of supporting documents for expenses and types of expenditure that can be made by the Grantee Institutions in relation to the project;
- What penalties are applicable if the Grantee Institutions delays the submission of the scientific and financial reports;
- If the researcher is unable to substantiate the expenses informed of the financial report, what penalty could be applied; and
- Lack of clear evidence that, if any contributor or member country suspends its contributions related with a specific project, the Institute can also stop transfers to the Grantee Institutions without the risk of future questioning of the Institute by the Grantee Institutions.

### ***Implications or risks to the Institute***

Possible questioning by the Grantee Institutions in the case of suspending annual contributions.

### ***Recommendation***

We recommend that the Institute prepare, with the help of specialists, a standard contract addressing all the weaknesses mentioned above and additional information to safeguard the Institute against any kind of questioning in the case of suspension of the annual contributions.

### ***Management comments:***

*These recommendations are being considered not only for the preparation of the contract for the CRN-II program, but also to be included in the Project Management Manual which is under preparation. Once the draft contract is ready IAI will seek advice from KPMG as well as from our attorney: Pinheiro Netto Advogados.*

## **5 Purchasing manual**

### ***Observed situation***

The Institute has a purchasing manual called “Contracting and Procurement 1996”, that has never been fully implemented or applied.

Currently, the Institute has a procedure implemented by the financial director, but it is not properly formalized.

### ***Implications or risks to the Institute***

Application of inadequate procedures in relation to the purchasing manual.

### ***Recommendation***

We recommend that the Institute review the procedures of the purchasing manual “Contracting and Procurement 1996” to adapt it to its needs, and also publicize the procedures to all Institute employees.

### ***Management comments:***

*The revision and adaptation of the “Contracting and Procurement Manual” is in the plan of the Directorate’s activities for the fiscal year 2004/2005. We expect that this work will be finished by the end of June 2005.*

*Until this manual is reviewed and approved, the purchases will follow the procedures of the “Purchase Threshold” and will only be authorized by the Director. In the case of the purchase of air tickets, there is a specific process in place included in the contracts signed with the travel agencies working with IAI.*

## **6 Hour bank**

### ***Observed situation***

At the Institute, employees that work overtime can compensate these hours on subsequent days. This procedure is characterized as an hour bank.

We found that the employees' contracts do not mention the hour bank for overtime worked by employees. Therefore, the agreement is informal, since it is not stated in the employees' contracts or a collective bargaining agreement.

In the case of international employees, it also does not have an agreement for the hour bank.



Mrs. Cláudia (HR) controls the hour bank, but we found that, in addition to Mrs. Cláudia, the IT Manager, Financial Director and Financial Assistant have access to the hour bank spreadsheet and, therefore, can modify the data.

***Implications or risks to the Institute***

Possible legal claims from the employees leading to labor contingencies.

Incorrect or inconsistent data input or altered in the hour bank spreadsheet by unauthorized individuals.

***Recommendation***

We recommend a review of the procedures currently adopted to strengthen internal controls. We recommend that only Mrs. Cláudia should have access to the hour bank spreadsheet to modify it.

***Management comments:***

*The issue of the regulation of the generation and use of the compensatory time is being addressed in the revision of the IAI Employee Manual.*

*With reference to the administrative controls over the annual and sick leave as well as over the compensatory time, the problem of the multiple access rights to the file was solved by setting a password which is requested anytime this file is opened. Only the person responsible for the maintenance of the file has the password to open it.*

*The IT Manager is studying the possibility to give access rights to this file. Once this is implemented, the Administrative and Financial Officer and the Financial Assistant will only have “read rights” while the person in charge of the maintenance of the data will have “read and write rights”.*