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CONTRACT AUDIT SERVICES

ENRON POWER AND PIPELINES
GUATEMALA OPERATIONS
MARCH 10, 1995

AGENDA

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Senate Finance Committee

EXHIBIT 28

SUMMARY OF AUDIT FINDINGS

1. Fuel Handling (P)

   a Fuel analyses are supplied with the tanker shipment No pre-unloading analyses are performed to screen incoming shipment and no independent analyses are performed to verify the supplier's analysis.

   Pre-unloading tests should be conducted in the plant laboratory before fuel is released for unloading to ensure that incoming fuels are within specification. In addition, fuel shipments should be analyzed by an outside laboratory to verify that the actual fuel content agrees with the supplier's shipping analyses

   b The quantities of sludge removed from the plant have been erratic and unpredictable. Volumes removed during 1994 ranged from 23,375 to 130,000 gallons per month. No sludge content analyses have been performed nor is information available pertaining to the amount of sludge which can normally be expected to be present in fuel oil. As a result, the plant has no effective means of evaluating the reasonableness of the sludge quantities being generated and removed.

   Detailed sludge analyses should be conducted to establish logical ranges of sludge content in fuel oil

   c From experience, it is known that engine valve and cylinder liner damage will result from high sludge content in fuel oil. Based on the characteristics of some of the other contaminates known to be present in fuel oil, it is conceivable that their presence in sufficient quantities could also cause engine damage.

   An investigation into the effects of fuel contaminants on engine performance and maintenance should be initiated with Wartsila. Depending on the results of this effort, consideration may have to be given to changing fuel oil specifications.

   d. Fuel leakage around the engines has been significantly reduced since the previous audit in 1993. However, leakage is still a serious problem.

   Efforts should continue to reduce the existing leakage problem to reduce oil losses, reduce safety and fire hazards, and improve housekeeping. Procedures to identify leaks such as the current walk around program should be strengthened.

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2. Environmental & Safety (P)

   a. Sludge is being hauled away at no cost by a local contractor. In exchange for the sludge, the contractor is providing environmental services. According to plant management, these services have not always been satisfactory.

      Alternative methods of sludge disposal should be pursued. The fuel supplier should be contacted to determine the approximate value of the sludge. The economics of selling sludge to local companies to generate revenue should be weighed against the cost of plant personnel performing the necessary environmental and pollution control activities.

   b. Rags used to wipe up oil are being burned at the site causing an air pollution problem. A contractor should be found to dispose of the oil rags.

   c. Several valves and sample points were omitted from the Dissolved Air Floatation (DAF) unit during its construction. These omissions plus the lack of removing any accumulated sludge from the unit since the plant became operational, have made it extremely difficult to meet oil limits specified in the Environmental Impact Assessment submitted to CONAMA for the operation of the unit.

      The DAF system was mechanically completed during our visit. Appropriate operating procedures should be developed with the support of Envirex and BETZ.

   d. The operation of the plant with the maintenance doors open results in noise levels outside the plant in excess of the limitations set out in the Environmental Impact Assessment. In addition, complaints of excessive noise have been voiced by both CONAMA and the Port Quetzal Commander.

      Management and supervision should ensure that the barge maintenance doors remain closed at all times.

   e The plant has no program to monitor the hearing capabilities of plant employees. This is contrary to the standard practices in all other Enron plants.

      A hearing testing program should be implemented for all employees.

3. Wartsila Diesel Engine Operation (P)

   a. Intake air and cooling water temperatures are experiencing above optimum levels and are occasionally exceed specifications. Such conditions will increase engine part wear and reduce the life of the engines.

      Management should concentrate on reducing engine temperatures by pursuing methods of maintaining cool temperatures in the charge air and cooling water systems. In addition, management should investigate the use of alternate air filtration systems. Finally, because the use of chemical treatment to inhibit sea water fouling is very expensive, other fouling control mechanisms should be investigated.

   b. Crankcase breather vents are not high enough to allow disbursement of the exhaust. As a result, the oil saturated air that is vented is circulating back into the engine air intakes.

      The solution to the crankcase breather vent problem should be implemented as a high priority item.

   c. The seventeen operations, maintenance, and installation manuals provided by Wartsila are too voluminous and cumbersome for efficient use by floor personnel. The Wartsila operating procedures should be reviewed, and simplified floor level procedures and checklists established.

   d. The lube oil supplier provides an analysis of oil supplied. An independent analysis should be performed periodically to ensure the accuracy of the supplier's analysis.

   e The plant has experienced ongoing problems getting adequate support in resolving technical issues and problems. Wartsila has not been totally cooperative in this area and EOC does not coordinate any exchange of information among its operating plants. Plant management attempted to satisfy this need through the establishment of a Wartsila users group. However, efforts to establish such a group have not been successful to date.

      A program should be instituted to establish a closer coordination with Wartsila and other engine users. In addition, EOC should establish a program to coordinate the exchange of information among Enron plants to resolve common technical issues and problems.

4. Water Treatment (P)

   a. The water management programs provided by the water treatment companies used to date have been erratic, resulting in corrosion and fouling problems in all plant water systems. In addition, corrosion has been observed on the system side of steam heated fuel heaters and in condensate systems.

      BETZ Water Treatment Company has been contracted to provide service and chemicals to establish an appropriate water management system. Management should monitor their performance to ensure all expected support activities are provided.

   b. The desalination units which provide boiler makeup water must be shut down periodically for mechanical descaling.

      Management, in conjunction with BETZ Water Treatment Company should investigate the possibility of using anti scaling methods to eliminate these shut downs.

   c. Closed loop cooling systems have not been monitored for corrosion and scaling. This could lead to reduced system flow resulting in higher engine operating temperatures.

      Management attention needs to be given toward monitoring corrosion and scaling in closed loop cooling systems. Consideration should be given to obtaining BETZ assistance in controlling the corrosion and scaling.

5. Communications with EEGSA (P)

   External Communications between the plant and EEGSA is by voice communication only. With the exception of operator logs, there is no written documentation to verify power requests received from EEGSA or availability reporting to EEGSA by the plant. (Prior Audit Finding)

   A more formal communication system, such as a telex system should be installed to support and document communications between the plant and EEGSA.

6. Training (P)

   a. Wartsila provided an initial training program for plant employees, and several specialized training programs have been held since the plant became operational. However, an ongoing training program needs to be implemented to provide continuous proficiency and upgrade training for all employees. (Prior Audit Finding)

      This recommendation has not been implemented. An ongoing training program is still needed and should be implemented.

   b. Based on the multitude of maintenance problems encountered by the plant since it became operational, the current skill levels of plant personnel can be considered to be below that required for successful operations. The probable cause for these conditions lies in the fact that the labor force has minimal to no experience in operating diesel engines. There is an obvious need for hands on training by qualified, expert personnel.

      To combat this situation, more expatriate technical support is needed. An operations engineer and a maintenance engineer should be brought in from Wartsila to assist the plant staff in day to day plant operations. In addition, the program of temporarily assigning a qualified, experienced individual from other EOC plants to act as Chief Engineer should be continued.

7 Communication & Coordination (P)

There is a serious lack of communication and coordination of activities between operations and maintenance personnel. Many instances have been observed where one group has taken unilateral actions having consequential effects on the other, without coordinating the action or communicating its occurrence.

Management should concentrate on a program to impress upon decision making individuals the importance of communications and the consequences of unilateral, uncoordinated actions.

8. Instrumentation Maintenance (P)

The instrument maintenance program is significantly flawed. Equipment indicator lights are not being maintained. Instruments were noted to be giving false readings. Lamp testing procedures, if in existence are not being followed.

Management needs to implement an effective instrumentation maintenance program.

9. Maintenance Work Orders (W)

An effective maintenance work order system is not in place at the plant. Repairs of equipment malfunctions and breakdowns are initiated through a verbal reporting system. (Prior Audit Finding)

Maintenance and repair work could be better managed, controlled, and costed with the implementation of a comprehensive work order system. A system is currently in place to prepare written requests for maintenance and repair work, but it is ancillary to the verbal system and is used only for low priority work.

10. Accuracy of Monthly Operations Reports W)

There is evidence the Monthly Reports are being issued without adequate verification of the accuracy or reliability of the data presented. Examples of inconsistencies in the 1994 reports include:

a Gross heat rate values appear as "Net Heat Rate" for the first five months of the year.

b. Heat rates reported in one month are changed in subsequent months with no explanation given.

c. The method of calculating the heat rate for June through December cannot be reconciled.

d. The reported amount of fuel oil consumed and electricity generated varies within monthly reports

11. Establishment of Target Heat Rate (W)

In the Turnkey Contract, Wartsila guaranteed a plant heat rate of 9225 BTU/kWH. This rate was achieved during their performance test, although the calculation of the rate was based on theoretical considerations.

a. The plant accepted 9225 BTU/kWH as the Target Rate for 1993. The actual average Net Heat Rate for 1993 was 9667 BTU/kWH.

b. The plant continued to use 9225 BTU/kWH as the Target Net Heat Rate in 1994. The reported average Net Heat Rate for 1994 was 9683 BTU/kWH.

c. The Annual Operating Plan for 1995 does not specify a Target Heat Rate as required by the O & M Agreement. The plan does present a Net Heat Rate in the Assumptions Section of 9582 BTU/kWH. However, the January 1995 Monthly Report presents the Target Rate as 9225 BTU/kWH.

12. Nonconformance of Semaelectro with Labor Contract (W)

a. The contract requires the Contractor to provide the Operator with certificates of insurance. Semaelectro has not complied with this requirement.

b. The contract requires the Contractor to submit its Drug Free Workplace and Testing Plan to the Operator. Semaelectro has not complied with this requirement.

13. Control of Scrap and Other Disposable Materials (W)

a. No accounting or physical controls have been maintained over scrap metal and used lube oil inventories. Materials accumulated over periods of time were occasionally removed from the plant and sold based solely on the verbal orders of the Plant Manager. No supporting documentation such as the preparation of disposition forms was accomplished to record and justify the transactions. Since the first sale, which occurred in September 1993, there have been a total of 17 sales of oil and two sales of scrap metal totaling approximately $38,300.

b. Until October 1994, all transactions were handled entirely at the plant level. Beginning in October, the Guatemala City office became involved to the extent of preparing and submitting invoices to the local vendors. However, the transactions were not booked and, upon receipt of payments from the vendors, the proceeds were forwarded on to the plant for their disposal.

c. Monies received from the sales were deposited in a non-company bank account maintained under the name of two individual plant employees. This account was established at the direction of the Plant Manager who while not a signatory on the account, utilized the funds at his discretion for the sponsorship or underwriting of employee activities and benefits. Since 1993, approximately $32,000 were expended as follows:

Soccer Team Equipment & Activities	$ 9,709
Diving Equip. & Training	4,511
English Language Course	19,573
Safety Shoes	2,403
Tennis Shoes	2,968
Plant Supplies	328
Special Occasion Parties	535
Total	$32,083

During the time of our audit, this account was closed and the balance of approximately $6,200 deposited to the plant field operations account. This sum needs to be transferred to PQPC as it represents the proceeds from the sale of liquidated owner assets.

14. Expiration of Plant Office & Warehouse Facility Lease W)

EEG leases an office and warehouse facility from the Puerto Quetzal Port Authority. The lease was executed in 1993 for a period of five years, with provisions for extension of the lease period contingent on the approval of both parties.

With the expiration of the lease approaching in 1998, the Port Authority has verbally indicated to plant management that the lease will not be extended and that EEG will be required to vacate the building. EEG has made no plans to acquire or build replacement facilities should the Port Authority take this action.

15. Consolidation of PQPC Offices (W)

The Guatemala City offices actually consist of two separate office areas. One office area is occupied by the Country Manager, his secretary, and a receptionist. Three vacant offices are maintained in this area for the occasional use of PQPC's legal counsel, public relations advisor, and out of country visitors.

The second set of five offices is devoted to accounting support personnel. One office will soon become vacant with the departure of the Financial Manager and the relocation of many plant accounting functions and responsibilities to the Plant Controller at the plant site.

With the departure of the Financial Manager, consideration should be given to the possibility of consolidating the Guatemala City office staff into one of the two existing areas. This would reduce the lease and maintenance costs by 50%, for a potential savings of $16,182 in the third year of the lease.

16. Board Approval of Budget Overruns (W)

The O & M Agreement states that without prior approval of the Owner, expenditures are not qualified for reimbursement if a line item exceeds 10% of its budgeted amount, or if the entire budget for the year is exceeded by $500,000.

Severe overruns in the O & M Budget occurred during 1994. These overruns were of the magnitude to require Owner Board of Director involvement in approving the expenditures to permit their submission as qualified reimbursements.

There is no evidence in the Minutes of the Board Meetings held in 1994 that Board approval was requested as required by the O & M Agreement.

17. O & M Expense Budgets & Variances (W)

In 1994, sixteen major Miscellaneous O & M accounts exceeded their budget by over 10%. The excesses, which amounted to $3,443,392, ranged from 19.2% to 204.8%, and average 80.5%. There is no documentation on file to explain these overruns or permit an analysis of the cause

There are no policies or procedures to ensure that a regular monthly analysis of significant budget variances is accomplished, and that causes are documented and reported. Additionally, in the absence of a routine investigative process, there is no mechanism to ensure that potential corrective actions are identified and taken.

The institution of variance analysis and documentation procedures should significantly improve management control over budgetary expenditures. In addition, the annual budgetary process would be simplified as the causes of variances from previous budgets would be known at all levels of management.

Plant Assets (W)

The generating plant and associated production support facilities is carried as a one line item asset with a depreciation term of 25 years. Many items included in the turnkey amount could be depreciated at a faster rate if listed as separate line item assets. In addition, there are no positive means to control asset inventories in the absence of a detailed listing. Periodic inventories cannot be performed to ensure assets are in place and have not been removed from the plant.

A detailed listing of all plant capital assets should be constructed, realistic depreciation terms should be applied to individual assets as permitted by law, and regular inventories of plant assets should be performed.

Inventories of Assets (W)

PQPC maintains a detailed asset listing for Computer equipment, furniture and fixtures, and emergency power generating equipment. The original value of the items listed was $140,652; current value is $94,993.

Periodic inventories are not taken to ensure assets are in place and have not been removed from the premises. In addition the individual assets are not tagged to permit easy identification.

20. Sun System Training

The Sun System is not being fully utilized. The plant does not use the system for inventory control. Further the accounting group has not been adequately trained in the use of many features, including financial tables, period cleardown, generation of payments, and time allocation and spread ratios.

Additional training is needed to fully realize the capabilities of the Sun System.

21. Employee Automobile Use Reimbursement (T)

Employees are being reimbursed $0.42 per mile when using their personal vehicle for company business. Enron Corp policy calls for a reimbursement of $0.29 per mile. During 1994, eight employees were reimbursed a total of approximately $28,000. One of the eight employees was reimbursed over $17,000 for driving 41,290 miles, the equivalent of a round trip between the port and Guatemala City five days a week for 50 weeks.

22. Direct Invoicing (T)

It was initially agreed between EEG and PQPC that EEG would pay all invoices because EEG was registered as a Guatemala corporation, and possessed import licenses and import duty exoneration. The O & M Agreement was subsequently amended to allow the PQPC to pay invoices directly.

Out of a sample of 32 invoices paid by EEG, 17 or 53% could have been paid directly by PQPC, thereby avoiding unnecessary and inefficient intercompany invoicing and recording.

23. Fuel Payment to Sun King (T)

In 1992, EDC purchased the PPA from Texas Ohio Power. As part of the transaction, EDC assumed the contractual responsibility for the payment to Sun King of a commission equal to 6% of PQPC's gross revenues for the 15 year life of the contract. Sun King subsequently claimed that these payments were to be tax free, and requested that the monies be deposited into a specific U.S. bank account.

Sun King is being accommodated through the cooperation of EPOS. In its invoices to EEG for fuel, EPOS adds on a Brokerage and Handling fee equivalent to the amount owed to Sun King for commissions. Upon receipt of payment, EPOS in turn deposits the commission payment into the Sun King account.

The practice of paying Sun King's fee through the fuel payment to EPOS on a tax free basis exposes EEG to a potential tax liability, including penalties. The price paid for fuel by EEG to EPOS is more than the price charged by EEG to PQPC as a reimbursable expense. The difference would be evident and would warrant an explanation to Guatemalan officials if exposed.

Furthermore, the payment to Sun King represents a commission payment to a corporation not domiciled in Guatemala. As such, there are specific taxes required by Guatemalan law to be withheld, and significant penalties (including criminal) for failure to do so. Based on total fees made to Sun King to date, a potential liability of approximately $1.6 million (not including compensatory interest) exists for 1994. This liability could approach $2.9 million by 1995 year end.

24. Allocation of Guatemala Office Overhead Expenses (T

Labor costs and other office expenses were not allocated to PQPC for 1993. Instead, the actual allocatable cost for 1993 was charged to PQPC at 1994 year end, together with the estimated allocation of 1994 expenses.

While EEG allocated labor and other office expenses of $524,852 in 1993 and $631,398 in 1994, PQPC booked $262,425 and $315,699 respectively. The amounts were reduced as a result of a PQPC management decision to forgive PQPC of its labor and office cost for 1993. This position was taken to allow PQPC to maintain a minimum debt service ratio necessary to declare a dividend per the IFC loan agreement.

Labor and Guatemala City office expenses were not included in PQPC's 1994 budget, resulting in a negative line item variance of $578,371.

EDC Cost Related to Guatemala City Office (T

The EEG General Manager spent approximately 4% of his chargeable time on EDC related activities per 1994 time sheets. This time, which was not charged to EDC amounted to approximately $6,000.

Customs Duties Levied on Imported Capital Assets T)

The generating plants were imported under an importation exemption which, while not in writing, was considered at that time by the project owners to be a permanent exemption. As a result of this action, neither import duties nor VAT were paid by PQPC to the Guatemalan government.

Since that time, there has been a change in government, which has interpreted the exemption to have been a temporary exoneration. Recognizing the differing opinions in the case, the Minister of Finance has allowed continuing, renewable temporary exemptions until a permanent solution is found.

The current plan is for PQPC officials to lobby the government for change in the current law, or to obtain a presidential decree to exonerate these obligations. At the present time, there are several scenarios being considered within the government which would reduce, delay, or eliminate the import duties. In the meantime, the Minister of Finance has taken the position that the 7% VAT totaling $6,349,000 will not be exonerated.