



DEFENSE CONTRACT AUDIT AGENCY
NORTHEASTERN REGION
EUROPEAN BRANCH OFFICE
Unit 29263
APO AE 09096

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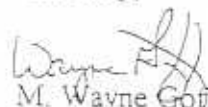
Board of Governors
Science and Technology Center of Ukraine
Laboratornij Provulok 3
Kiev, 252133, Ukraine

In planning and performing our audit of the financial statements of the Science and Technology Center of Ukraine for the year ended 31 December 1995 we, noted certain weaknesses in the design and operation of the internal control structure. These weaknesses, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. We considered these weaknesses in determining the nature, timing, and extent of the audit procedures necessary to audit the financial statements, and did not necessarily disclose all the weaknesses in the internal control structure.

During our January 1997 visit to the STCU, we noted that significant improvements to the internal control structure were made in 1996. However, certain deficiencies in the design and operation of the internal control structure still exist which may impact the STCU's ability to produce and report accurate and reliable financial information. Details of the internal control deficiencies and our recommendations to correct them are in the attached appendices. We discussed our findings and recommendations with STCU management, and have included their comments in the attachments as well. We recommend that STCU management submit a corrective action plan addressing these internal control deficiencies.

Our reporting of these matters is intended solely for the information and use of the Board of Governors, management, and others within the Science and Technology Center of Ukraine. Please direct any questions to the undersigned or Seay Anne Sheley, Supervisory Auditor, at telephone number 49-611-380-7509. Our FAX number is 49-611-380-7507.

Sincerely,


M. Wayne Gott
Branch Manager

Copy Furnished:
United States' Office of the Department of Defense (Comptroller)

INADEQUATE DOCUMENTATION OF BANK RECONCILIATIONS

Condition:

The STCU's bank reconciliation procedures do not provide an adequate audit trail between the transactions booked in the accounting records and the transactions on the bank statement. Additionally, the actions taken to resolve non-reconciling items are not documented on the reconciliation worksheet.

Proper completion and documentation of bank reconciliations are essential to the control of cash. By properly documenting the reconciliation and actions taken to correct non-reconciling items, the person responsible for preparing the reconciliations creates an audit trail which can be followed to verify the cash booked in the accounting records agrees with the cash in the bank accounts. Without adequate documentation, even a properly completed reconciliation will not provide an adequate audit trail.

During our review of the STCU's internal controls, we examined selected 1996 monthly bank reconciliation worksheets to verify they were being properly completed and documented. We found the reconciliations were done on a timely basis by someone independent of the person recording the cash transactions. However, the reconciliations we reviewed were not documented in a manner which allows for audit verification. The general ledger transaction listing included to support the reconciliation summary sheet did not include tick marks to indicate which items reconciled to the bank statement and which items did not. In addition, the disposition of the non-reconciling items was not adequately documented. Without this documentation, an audit trail does not exist.

Recommendation:

We recommend the STCU revise their accounting practices to ensure each monthly reconciliation worksheet is supported by a copy of the bank statement and a copy of the monthly general ledger transaction listing. These sheets should include tick marks to indicate that the individual transactions were traced from the bank statement to the general ledger listing. For items which don't reconcile, a note should be included which explains the reason the item doesn't reconcile and the disposition or corrective action taken. The person responsible for reviewing the monthly bank reconciliation should ensure the worksheet package adequately documents the reconciliation before the summary sheet is approved.

STCU Reaction:

The STCU concurs with our findings and recommendation and will implement our recommendations for future bank reconciliations.

INADEQUATE POLICIES AND PROCEDURES FOR ACCOUNTING AND CONTROL OF GOODS AND SERVICES ACQUIRED

Condition:

The STCU lacks formal written policies and procedures for the acquisition and accounting of goods and services and lacks key internal controls for processing vouchers for payment of goods and services. Inadequate internal controls would require us to assume maximum control risk during a financial statement audit which would require us to perform maximum transaction testing.

Adequate internal control procedures for acquisition of goods and services include:

- Existence of supporting documentation such as purchase order, receiving report, and invoice attached to the voucher; cancellation of documents to prevent their reuse; internal verification of vendor's invoices, receiving reports, purchase orders, and purchase requisitions. The existence of supporting documents attached to vouchers and their internal verification and cancellation would meet the internal control objective that recorded acquisitions are correctly valued, valid and for goods and services received, and consistent with the best interests of the STCU.
- Prenumbered vouchers, receiving reports, and purchase orders and procedures to account for all prenumbered vouchers, receiving reports, and purchase orders. The use of vouchers, receiving reports, and purchase orders that are prenumbered and accounted for would lower the risk that existing transactions are not accounted for.
- Procedures requiring recording of transactions as soon as possible after the goods and services have been received. Procedures requiring recording transactions as soon as possible after the receipt of goods and services would help ensure transactions are recorded on a timely basis.
- Approval of acquisitions at the proper level. Approval of acquisitions at the proper level would lower the risk that acquisition transactions are not authorized.
- Verification of receipt of goods and services prior to payment. Verification of receipt of goods prior to payment reduces the risk of payment for non-existent goods or services.

We reviewed a sample of calendar year 1996 working cash transactions, Bankers Trust payments for goods and services, and project costs incurred and noted the following consistent deficiencies:

- Several vouchers had no supporting documentation attached.
- Several vouchers lacked proper approval in accordance with the STCU's own policies and procedures. One employee approved his own travel voucher for payment.
- Significantly all the vouchers reviewed had no indication of internal verification such as checking the footings and extensions on invoices, comparing the voucher amount to the invoice and other supporting documentation.
- Several vouchers had no documentation of receipt of goods. The STCU does not use receiving reports to document receipt of goods.
- Significantly all the vouchers had supporting documents that were not canceled.
- Several vouchers had no indication the transaction was posted. Our review was at least one month after the transaction date.
- One working cash voucher could not be located and two Bankers Trust (electronic transfer) vouchers had the same number. The contractor does not use prenumbered vouchers.

Recommendation:

We recommend the STCU implement formal written policies and procedures for purchasing and accounting and control of goods and services acquired to include the following:

- Vouchers for goods and services acquired should not be paid without adequate supporting documentation such as invoice, receiving report, purchase order, and documentation of proper authorization for the transaction.
- Procedures for internal verification (such as math checks of amounts, verification that types and quantities of goods ordered match goods received, etc.) of amounts on vendor invoices, receiving reports, and purchase orders and cancellation of these supporting documents once the goods have been received and paid. The payment voucher should document the performance of these procedures.

- Procedures requiring recording of transactions as soon as possible after the goods and services have been received or paid for. We recommend project costs be recorded in the Access job costing data base and administrative expenses recorded in ACCPAC within one week. The posting date and other accounting information (such as debit and credit amounts and account numbers) should be documented on the voucher.
- Use of receiving reports to document the receipt of goods which are forwarded to the accounting department for comparison to the invoice and purchase order before payment of the voucher. When it is not practical to obtain the receiving report prior to payment, we recommend the STCU follow up on a timely basis to obtain the receiving documents.
- Purchasing procedures should be formally written and approved by the executive director. In addition, the STCU should use prenumbered purchase orders, and the chief administrative officer should maintain a buyer's file for all acquisitions exceeding \$2,500. The buyer's file should contain documentation and information on competitive bids and the rationale for vendor selection.
- The vouchers, receiving reports, and purchase orders should be prenumbered and accounted for by independent personnel.

STCU Reaction:

The STCU concurs with our audit findings and recommendations with the following exceptions:

- STCU states that they cannot wait until receipt of goods and services before making the payment since Ukrainian vendors normally require full payment of the purchase price prior to delivery of goods.
- The STCU is not certain whether the use of prenumbered documents is practical but will study our recommendation.
- The STCU does not require the use of purchase orders for project goods and services since their approval is contained in the project agreements.

Auditor's Comments:

We offer the following comments regarding the STCU reaction;

- We agree that in some cases it would be difficult to obtain delivery of goods and services prior to payment. However the STCU should follow up with the vendors in these cases until the goods and services are delivered and match the receiving documents to the paid invoices.
- We agree with the STCU that the use of purchase orders for project acquisitions is not required since approval is contained in the project agreements. However, we believe properly approved purchase orders should still be required for administrative purchases.

INADEQUATE PROCEDURES FOR ADMINISTRATIVE PAYROLL

Condition:

The STCU lacks adequate procedures for processing administrative payroll. Specifically, we noted:

- There is no separation of duties between personnel, timekeeping, and payroll disbursement.
- Administrative employees do not certify to time worked; and
- Administrative employees do not document that they received the net pay specified in the payroll records.

To ensure recorded payroll payments are for work actually performed by valid employees, the STCU must have formal written policies and procedures for the administrative payroll function. These policies and procedures should require a separation of duties between the personnel, timekeeping, and payroll disbursements functions. A fundamental concept of accounting control is that no one person or department should handle all aspects of a transaction from beginning to end.

The chief administrative officer of the STCU is currently responsible for maintaining personnel records, timekeeping, and disbursing payroll in cash for the administrative employees of the STCU. In addition, the timesheets submitted to record hours worked are not signed by the administrative employees, and the employees do not document the amount of cash received for net pay.

The lack of the above key internal controls would increase the risk that recorded payroll payments are not valid or reasonable and/or for work actually performed.

Recommendation:

We recommend the STCU establish formal written policies and procedures for the administrative payroll function to include:

- Separation of duties between personnel, timekeeping, and payroll disbursement.
- Requirements for employees to sign timesheets to certify hours worked.
- Signatures of each employee testifying to the amount of net pay received in cash.

- Requirements for the payroll transactions to be examined for reasonableness on a periodic basis by an individual independent of personnel, timekeeping, or payroll disbursement.

STCU Reaction:

The STCU concurs with the audit findings and recommendations and has begun corrective action.

INADEQUATE PROCEDURES TO ASSURE FULL DISCLOSURE OF RELATED PARTY TRANSACTIONS

Condition:

The STCU does not have adequate policies and procedures in place to assure full disclosure of related party transactions.

Financial statement disclosure of all material related party transactions is required by International Accounting Standard 24. Transactions between related parties must be accounted for in a manner which reflects the true economic substance of the transaction rather than the legal form of the transaction. These transactions cannot be presumed to be carried out at arm's length when one related party has the ability to significantly influence the management or operating policies of the related party.

The STCU does not require key management employees to complete conflict of interest statements. Conflict of interest statements are annual statements completed by an individual to disclose all organizations with which the person has a personal financial interest (related parties). The Chief Financial Officer (CFO), who approves all requests for payment, is the only executive officer who has completed such a statement. These financial statements should be completed by any person having a direct or indirect influence on the purchasing and approval of purchases of goods and services. At a minimum, this would include the Executive Director and Chief Administrative Officer in addition to the Chief Financial Officer. At this time, submission of the financial statement by the CFO mitigates the severity of this deficiency on the integrity of the financial statements taken as a whole.

Nonetheless, we continue to consider this condition to be a deficiency because the STCU cannot review and adequately disclose related party transactions if they are unaware of the companies with which its board members and key employees are affiliated. Failure to require these employees to submit conflict of interest statements increases the risk that significant related party transactions will not be properly disclosed in the financial statements.

Recommendation:

We recommend the STCU require key employees to complete a conflict of interest statement on an annual basis which discloses all companies in which the employee has a financial interest. STCU management should review material transactions with related parties to assure the amounts booked in the general ledger reflect the economic substance of the transaction and to determine whether financial statement disclosure of the transaction is required.

STCU Reaction:

The STCU does not concur with the audit findings or recommendations.

Auditor's Comments:

The STCU has not furnished a reason for not concurring with the audit findings and recommendation. We maintain our position until the STCU furnishes a valid reason why they should not have key employees complete conflict of interest statements to ensure compliance with International Accounting Standard 24.

MONTHLY AND YEAR END CLOSING OF BOOKS

Condition:

The STCU lacks formal written policies and procedures for the monthly and year-end closing of books.

Common accounting practice is to close out a month within 1-2 weeks after the end of an accounting month. This discipline is necessary in order to produce relevant and reliable accounting information to be used as a basis for budgetary control and managerial decisions. Consistent application of monthly and year-end close-out procedures would increase the reliability and integrity of interim and final financial statements.

Recommendation:

We recommend the STCU establish and implement written policies and procedures requiring the accounting staff to perform the following procedures on a monthly basis:

- Close the books and records as soon as practical after month end.
- Print and maintain the period's general ledger transaction listing, batch listings, and all supporting source and posting journals.
- Perform a count of working cash by someone independent of the treasury function.
- Perform a bank reconciliation.
- Perform reconciliation of general ledger control accounts to subsidiary ledgers. For example, reconcile the accounts payable subsidiary ledger to the accounts payable general ledger account(s), and reconcile the Access job costing database to the general ledger project expense accounts.

STCU Reaction:

The STCU concurs with the audit findings and recommendations and is currently drafting procedures for year-end closing of the books.