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Science Technology Centre in Ukraine

Management Letter for the year
ended
31 December 2014





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Private and confidential

20 April 2015

Dear Mr. Curtis M. Bjelajac and Mr. Anthony Nichol,

We have audited the financial statements of the Science and Technology Center in Ukraine (hereinafter "STCU") as at and for the year ended 31 December 2014.

Our audit procedures are designed primarily to enable us to provide an opinion on the financial statements, and therefore will not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the STCU gained during our work to make comments and suggestions that we hope will be useful to you.

During the performance of our audit, we noted certain matters that are presented for your consideration. Our comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control structure or result in other operating efficiencies and are noted in the attached appendix. This management letter also includes the responses by management to our recommendations.

We would like to express our appreciation to the management and employees of the STCU for their cooperation during the audit.

We would be pleased to discuss these comments and recommendations with you at any time. This report is intended solely for the information and use of the management.

Yours sincerely,
KPMG Baltics SIA

Armine Movsisjana
Partner

Contents

1	Valuation of account receivables	3
2	Identification of equipment at Institutes	4
3	Expense classification	5
4	Procurement procedure	6

1 Valuation of account receivables

Observation

During audit of the financial statements 2014 we identified two projects: P610 and P542 which have been either suspended or no financing was received from the Partner for several years. However, STCU does not suspend and terminate these projects, but rather keeps balances in its financial records and recognizes no impairment.

Implication

As per article in the project agreement STCU reserves the right to suspend the project and further terminate the project, in case the period of suspension expires and no resolution is identified. Furthermore, STCU cannot write off or impair account receivable and Designated Capital Contribution balances while the project is not officially terminated. Accordingly, by not terminating the non-performing projects, STCU overestimates its balance sheet, namely account receivable and Designated Capital Contribution positions.

Recommendation

We recommend the management of the STCU to develop a timeframe according to which in case the Partner does not provide financing, STCU have rights to suspend the project and further terminate it with respective entries made to the financial statements so that receivable balances are measured in accordance with IAS 39 at recoverable value.

Management response

STCU has had no indication from these Partners that they wish to cease funding these projects. Until we hear to the contrary STCU will continue to keep these projects open so further funding can be possible. Should the collectability of the accounts receivable be considered doubtful provision will be made.

Efforts are being made to establish from the Partners their future intentions.

2 Identification of equipment at Institutes

Observation

The STCU policy on identification of purchased equipment for STCU projects implies that all equipment needs to be clearly labelled showing STCU identification number, project number and serial number. Labels on all equipment should be placed on the equipment within one week of the receipt of the equipment.

During the visits to institutes, we noticed that two laptops of project P506 in Tbilisi are not labelled with STCU identification labels.

Implication

Equipment without STCU identification numbers can be easily switched or replaced by other equipment. Moreover, the equipment may then be used for purposes outside the project scope. Such approach may be against project agreement provisions and result sanctions against the STCU by the funding party.

Recommendation

We recommend to the management of the STCU during next audit in institute P506 to ensure all equipment is labelled according the STCU policy. We recommend the STCU to follow measures to monitor that equipment labelling is maintained on all projects.

Management response

STCU attempts to ensure all equipment is labelled according to policy, however there will be some cases, due to the spread of geographic locations, when there are such lapses in this regard.

Checking of equipment labels is part of the regular project monitoring.

Project P506 is now closed and so there will be no further monitoring of the project and the title to the equipment has passed from the STCU to the institute.

3 Expense classification

Observation

Every STCU signed project agreement has an annex describing categories of expenses applicable for project. Every expense item should be classified with the appropriate category.

During the audit, we discovered that wrong classification had been used for expenses of projects 9805 and P554. Other direct cost category is used instead of travel and materials.

Implication

While there is no impact on the presentation of financial results in the financial statements, as in financial statement project expenses are reflected as one number, when wrong classification is used for the expenses, comparability principles cannot be applied.

Recommendation

We recommend to the management of the STCU to ensure expenses classification based on the nature of expense.

Management response

Noted, STCU uses the correct expense classification whenever possible. These two instances had been noted and the classification corrected.

4 Procurement procedure

Observation

The standard STCU procurement process implies that where individual expenditure in excess of 2 500 USD (from December 2014 in excess of 10 000 USD) is incurred on projects the Institute should provide several informal written quotations for analysis and determination of price reasonableness. In addition, special conditions on several Partner projects allow not carrying out this procedure, where the Partner provides a written confirmation to the STCU on the specific vendors and the components, materials, and service contracts that each identified vendor will supply and this information is reviewed by the STCU.

During the audit we noticed that several Projects namely P459, P547, P633 included purchases from the same supplier and on the same date or close dates where expenses of individual purchase invoices are below 2 500 USD, but by aggregating these purchase invoices expense amount would exceed 2 500 USD (purchases until December 2014). We are not aware if price comparison was performed in these procurement processes; however, we have verified that no Partner approval was received (which would be required under procurement rule had the threshold been exceeded).

Implication

While the instances noted above do not seem to contradict the STCU procurement policies, we see potential risk of intentional misuse of the policies. While the current procurement policy introduces measures against “splitting” – entering into a number of direct contracting deals with the same supplier for amounts individually not exceeding the threshold of 2 500 USD (from December 2014 10 000 USD), while in substance all represent one procurement and are subject to additional controls and approvals.

Recommendation

We recommend project managers and internal audit to ensure that established procurement policy is closely followed and instances of splitting are avoided.

Management response

The use of the practice of “splitting” by project managers as a potential misuse of Procurement policies is noted. STCU will remind project managers of this updating the Project Procurement Manual as required. Project procurements will be checked against project budgets to identify future occurrences of such instances by project managers and to ensure that they follow STCU Procurement Rules.

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