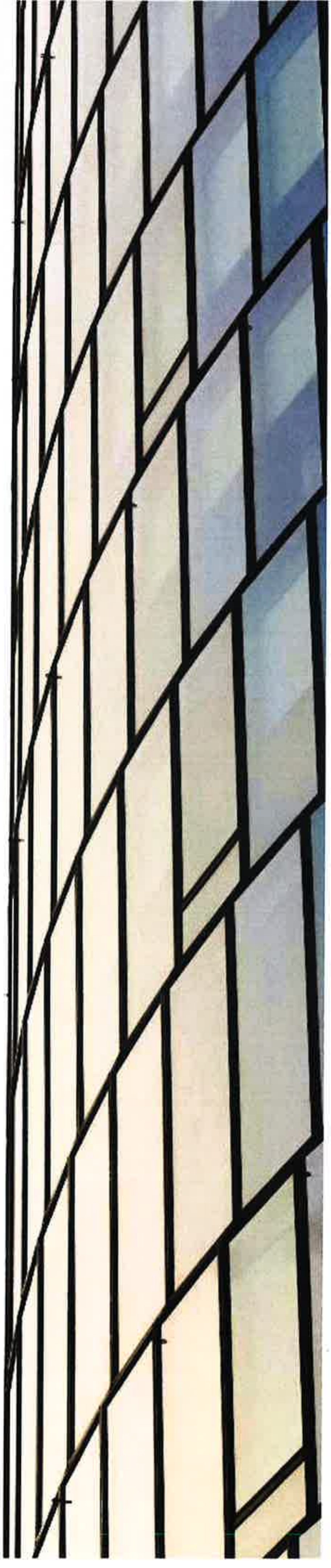
KPMG

Science Technology Centre in Ukraine Management Letter

For the year ended 31 December 2015



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Private and confidential

28 April 2016

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 2015.

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

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1 Procurement procedure

Observation

The standard STCU procurement process implies that where individual expenditure 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.

During the audit we noticed that on the project P003p there were purchases from the same supplier ТОВ "ТЕХЕЛЕМЕНТ" on 30 March 2015 and 7 April 2015 where expenses of individual purchase invoices were below 10 000 USD, but by aggregating these purchase invoices expense amount would exceed 10 000 USD. The STCU has obtained written quotation only for the one supplier; while as per procurement police - a contract including an invoice over 10 000 USD should obtain direct placement (2-3 informal written quotation should be obtained for analysis).

Implication

The instance noted above contradict the STCU procurement policies. Additionally, 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 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

STCU will endeavour to be more observant of instances such as this where Project managers have not correctly applied STCU procurement procedures. We emphasize that there is only one instance noted by the auditors for the whole year.

2 Expense periodisation

Observation

During the course of audit we have discovered instances when expenses are not recorded based on accrual basis. For example there were no accruals made for travel expenses occurred during 2014 for project P552. Travelling expenses were recognised in the Statement of Revenues and Expenditure in 2015. There was also expense for Professional training which occur partly in 2014 and 2015 for project P552; however full expense amount was recognised in 2015.

We have also discovered that unrecoverable Partner fee for projects P542, P610, recognised in the year of the project commencement, is written off in the Statement of Revenues and Expenditure when the Partner project is terminated.

Implications

IAS 1 requires that an entity prepare its financial statements, using the accrual basis of accounting. Recognising expenses in different financial period from when these expenses incurred diagree with accruals accouting basis.

Recommendation

We suggest to the Company to establish control procedure to monitor the timing of expense recognition. Implementation of the control would ensure accurate expense recognition and matching it with goods or services received and income recognized.

Management response

Ageed STCU needs to be more attentive in identifying expenditures that require accrual at the year end.

Having changed the accounting policy for partner fee recognition in 2015, to bring it into line with IFRS this mismatch should not occur in the future.

3 Bank charges

Observation

During the course of audit we have discovered inappropriate accounting recognition for the difference arising between cash received from the Partner in the STCU bank's account and the amount sent by the Partner. The full amount of funding is stated in the Project agreement; therefore the Partner does not separately account for bank charges. Instead the STCU should have treated these bank charges as expenses and recognised in the Statement of Revenues and Expenditure upon cash receiving. For example, for projects P620 and P613 there are difference between account receivables as of 31 December 2015 stated by Partners and the STCU records. The difference arose due to bank charges for which the STCU has not accounted for.

Furthermore, we have discovered that there was an instance when bank charges for cash received for project P572, P572a were covered with unspent cash resources of closed project P468.

Implications

Bank charges are not budgeted separatly in the Project agreement; therefore the STCU should treat bank charges as expenses and recognise in the Statement of Revenues and Expenditure as soon as transaction arises.

Without having a clause on action regarding unspent cash resources of closed projects, the STCU puts itself into risk.

Recommendation

We suggest to the STCU to establish control over reporting to unspent amount from the project to the Project Partner and/or the STCU can add a condition in the Project agreement stating that after certain period of time after project closure all unspent cash resources are redirected to Undesignated Contribution capital and the STCU can decide how to allocate these resources.
We also suggest to establish weekly/monthly control over bank charges recognition in the Statement of Revenues and Expenditure.

Management response

Agreed bank charges incurred on receipt of payments from partners will be charged only to income and expenditure in future.
The amounts involved are usually minimal and partners consider that once monies are paid to STCU that those monies are the total expenditure and do not request refunds. The exception to this is for projects that are terminated early or do not start for various reasons in which case the full amount of unspent monies are refunded. Management are of the opinion that for the amounts involved change to the partner agreement and paying refunds is not cost effective.

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