SCIENCE AND TECHNOLOGY CENTER IN UKRAINE

Financial Statements for the
Year Ended 31 December 2004

Lubbock Fine
Chartered Accountants
Registered Auditors

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE

TABLE OF CONTENTS

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE

INDEPENDENT AUDITORS' REPORT TO THE BOARD OF GOVERNORS

We have audited the financial statements, set out on pages 2 to 21, of the Science and Technology Center in Ukraine as at 31 December 2004 at the request of the Board of Governors. The financial statements comprise the Statement of Revenues and Expenditure, the Balance Sheet, the Statement of Cash Flows and the Notes to the financial statements. These financial statements are the responsibility of the management of the Science and Technology Center in Ukraine. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following two paragraphs, we conducted our audit in accordance with International Standards on Auditing. These Standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles and policies adopted and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The terms of the project agreements, concluded between the Science and Technology Center in Ukraine and the recipient institutes, state that grant costs for a specific period of time may not be claimed by the recipient institutes if they are receiving reimbursements from other funding sources for the same period of time. Due to our inability to access appropriate records of the recipient institutes we were unable to satisfy ourselves as to whether the claims made by the recipient institutes include amounts for which they may have received reimbursements from other funding sources. There were no alternative audit procedures that we could adopt to confirm the above.

As more fully explained in the Accounting Policies, fixed assets used for both the Center and the projects funded by the Science and Technology Center in Ukraine, which have useful lives extending beyond the current year were expensed immediately on acquisition to the Statement of Revenues and Expenditure. The management of the Science and Technology Center in Ukraine believe that because of the unusual nature and circumstances of its activities this treatment properly matches the revenues specifically contributed by the funding parties with the related expenditure. International Accounting Standard 16 requires Property, plant and equipment to be capitalized and depreciated over their expected useful lives. Capitalization and depreciation of fixed assets used for the Center and projects would have a consequential effect on the accompanying financial statements if it were applied.

In our opinion, except for adjustments that might be necessary as a result of the matters noted above, the financial statements give a true and fair view of the financial position of the Science and Technology Center in Ukraine as at 31 December 2004, and of the results of its operations and its cash flows for the year then ended and have been prepared in accordance with International Financial Reporting Standards.

Lubbock Fine
London

Lubbock Fine

13 MAY 2005

Overview of the Science and Technology Center in Ukraine (STCU)

The Science and Technology Center in Ukraine (STCU) is an intergovernmental organization dedicated to nonproliferation of technologies and expertise related to weapons of mass destruction, including nuclear, biological and chemical weapons, and their delivery systems.

The United States, Canada, Sweden and Ukraine signed the agreement establishing the Science and Technology Center in Ukraine on October 25, 1993 (referred to as "the STCU agreement"). The European Communities acceded to the STCU agreement on November 26, 1998, and in so doing, replaced Sweden as a party to the STCU agreement.

The STCU helps develop, finance and monitor science and technology projects that engage the former Soviet weapons community in Ukraine, Azerbaijan, Uzbekistan, Georgia, and Moldova in peaceful civilian activities. The Funding Parties of STCU projects include: the signatories to the STCU agreement, Japan as a sponsor of the STCU agreement and Partners (government and non-government) approved by the Board of Governors.

The STCU is a legal entity and has been registered by the Ministry of Foreign Affairs of Ukraine as an intergovernmental organization with its headquarters in 21 Kameniariv, Kyiv, Ukraine 03138. The STCU has an international staff of 72 full time scientific, financial and administrative experts.

Basis of Preparation

The financial statements have been prepared under the historic cost convention and in accordance with applicable International Financial Reporting Standards (IFRS) except for International Accounting Standard (IAS) 16 relating to Property, plant and equipment as explained in the policy for Property, plant and equipment.

The financial statements have been prepared in United States Dollars (USD), as required by the STCU's Financial Regulations.

Project Activity

The STCU authorizes and funds scientific projects which are performed at institutions within Ukraine, Azerbaijan, Uzbekistan Georgia and Moldova. Projects are financed by the Funding Parties either individually or jointly. All project agreements include a maximum amount of funding to be provided by the Funding Parties.

The project activity is accounted in the financial statements as follows:

Project Recognition

The projects are only recognized after signature of the project agreement between the STCU and the recipient institutes. Upon signature, the total project value is credited to the relevant Funding Parties Designated Capital Account in proportion to the level of funding agreed by each party. To the extent that the value of the signed projects are not covered by advance payments from the respective Funding Parties, a receivable is set up in the financial statements.

Project Expenditure

Project costs consist of three main components: grants to scientists, equipment and overhead. The STCU, being a non-profit making inter-governmental organization, does not envisage that any economic benefits will accrue to it in the foreseeable future from the financing of these projects. Accordingly all project costs incurred, including the purchase of project equipment, are charged immediately to the Statement of Revenues and Expenditure. Projects are performed on a cost reimbursable basis, with ceiling funds specified in the project agreements.

The STCU temporarily retains 50 percent of the allowable overhead for the individual projects, in accordance with the project agreements, until the submission, and acceptance of, the financial and technical reports prepared by the project recipients.

When a project has been completed, any funds committed in excess of actual costs are credited back to the relevant Funding Parties’ Undesignated Capital Contributions Account.

Project Revenues

Project revenues recognized during the year in the Statement of Revenues and Expenditure are amounts equal to the total value of project expenditure incurred and written off during the year. These revenues are transferred from the Funding Parties’ Designated Capital Accounts for Projects.

Administrative and Supplemental Revenues and Expenditure

Administrative Operating Budget

Administrative Revenues recognized in the Statement of Revenues and Expenditure during the year equate to the amounts approved by the Board of Governors for the Administrative Operating Budget for the year. The budget is set and agreed at meetings of the Board of Governors in the previous financial year. The agreed budgeted amounts are transferred from the Designated Capital

Accounts for Administrative Expenses of the United States, Canada, the European Union, and Ukraine.

Administrative Expenses are charged to the Statement of Revenues and Expenditure when incurred and are matched against the Administrative Revenues for the year.

Surplus Administrative Revenues arising during the year are re-allocated to the Undesignated Capital Contributions Accounts of the United States, Canada, and the European Union in the same ratio as the Administrative Revenues contributions.

Supplemental Budget

Supplemental Budgets are approved by the Board of Governors to provide funding for activities that are outside the scope of the Administrative Operating Budget and not directly related to the implementation of projects. Upon agreement of the Supplemental Budgets at Governing Board Meetings the total amount of such budgets approved are credited to the relevant Funding Parties Designated Capital Accounts for Supplemental Budgets in proportion to the level of funding agreed by each party.

Supplemental Budget expenses are charged to the Statement of Revenues and Expenditure when incurred. Supplemental Budget revenues recognized in the year are amounts equal to the value of the Supplemental Budget expenditure incurred in the year. These revenues are transferred from the Funding Parties Designated Capital Accounts for Supplemental Budgets.

Partner Fees and Interest

Partner projects may be charged a fee, usually 5% of the total project cost, for the services provided by the STCU to administer the project, which are recognized in the Statement of Revenues and Expenditure. The surplus partner fees are allocated to the Undesignated Capital Contributions Accounts of the United States, Canada, and the European Union in the same ratio as their Administrative Revenues contributions.

Interest earned on Funding Party bank accounts is recognized in the Statement of Revenues and Expenditure. Surplus interest earned is allocated to the Funding Parties Undesignated Capital Contributions Accounts, with the exception of Partner interest earned, which is allocated to the Undesignated Capital Contributions Accounts of the United States, Canada, and the European Union in the same ratio as their Administrative Revenues contributions. Interest earned on administrative and supplemental bank accounts is allocated to the Undesignated Capital Contributions Accounts of the United States, Canada, and the European Union in the same ratio as their Administrative Revenues contributions.

Property, Plant and Equipment

Property, plant and equipment are acquired either for the Center's own use or for the projects and comprises of the following:

Center

Property and equipment acquired by the Center for administrative operations consist of vehicles, office furniture and equipment, including computer hardware and software and communications devices. All commitments and expenditures for administrative equipment are made in accordance with the Board's approved annual budget.

The cost of the Center's equipment is charged to the Statement of Revenues and Expenditure when acquired.

Project Equipment

Since the STCU does not expect to derive any foreseeable economic benefits from the ownership of project equipment, the expenditure incurred during the year on equipment under each project, is written off to the Statement of Revenues and Expenditure.

IAS 16 requires Property, plant and equipment with useful lives of beyond the current accounting period be capitalized and depreciated over their useful lives. The management believe that because of the unusual nature and circumstances of its activities, strict interpretation and application of this standard would not properly match the revenues specifically contributed by the funding parties with the related expenditure. Accordingly, the property, plant and equipment acquired for use by the Center and also the projects are charged in full upon acquisition to the Statement of Revenues and Expenditure in accordance with the accounting policy for property, plant and equipment set out above.

Cash at bank and in hand

Cash at bank and in hand includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

Foreign Currency Transactions

All foreign currency transactions are converted into USD at the exchange rates prevailing at the date of the transaction. Foreign currency gains and losses resulting from movements in the exchange rates between the date of the transactions and the date of settlement are charged to the Statement of Revenues and Expenditure under the administrative operating budget in the period incurred. Activities in Azerbaijan, Uzbekistan, Georgia, and Moldova are transacted in USD and, therefore do not result in any gains or losses from currency exchanges.

European Union Funded Projects

Due to the fact that all projects financed by the European Union are funded in Euro and the requirement that the STCU financial statements are maintained in USD, all European Union funded projects have to be expressed in USD. The manner in which these commitments are expressed is set out below.

Projects Signed at or Subsequent to the 10th Board of Governors Meeting Conducted on June 1, 2000

Project agreements approved by the European Union at all Governing Board Meetings prior to the 10th Board of Governors Meeting are concluded in USD.

Project agreements approved by the European Union at all Governing Board Meetings including and subsequent to the 10th Board of Governors Meeting are concluded in Euros if solely funded by the European Union, and in USD if projects are jointly funded.

In relation to project agreement procedures for European Union projects approved at or subsequent to the 10th Board of Governors Meeting, concluded in USD, the Executive Director of the STCU assigns these projects a Euro to USD exchange rate on the date the Board funding table is signed. The exchange rate assigned incorporates a financial safety margin for each approved project in the amount of 5% of the exchange rate on the date of the signature of the Board funding table. The European Union then provides funding at some later date in Euros, and the STCU immediately converts the Euros upon receipt into USD. If a reserve remains, it is withheld by the STCU until the total amount of Euros provided by the European Union is converted into USD, and the total amount of USD provided by the European Union is known. The project agreements are then formally amended accordingly to match the amount of USD received, including the reserve if available.

Projects Signed at or subsequent to the 17th Board of Governors Meeting Conducted on December 4, 2003

Project agreements approved by the European Union at all Governing Board Meetings including and subsequent to the 17th Board of Governors Meeting are concluded in Euros if solely funded by the European Union, and in USD if projects are jointly funded.

The project agreement procedures for projects approved at or subsequent to the 17th Board of Governors Meeting, concluded in USD, differ from the aforementioned procedures for projects financed by the European Union at or subsequent to the 10th STCU Board of Governors Meeting.

The European Union provides funding in Euros, before the projects are signed by the STCU Executive Director, and the STCU immediately converts the Euros upon receipt into USD. The total amount of USD provided by the European Union is therefore known before the start of the project, and thus the project agreements are written to match the amount of USD received.

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE

STATEMENT OF REVENUES AND EXPENDITURE
FOR THE YEAR ENDED 31 DECEMBER 2004

	Note	2004 USD	2003 USD
REVENUES			
Project Revenue		17,675,237	17,937,532
Administrative Revenue			
- Administrative Operating Budget		1,891,037	1,755,512
- Supplemental Budget		1,946,671	1,483,183
New Building Fund		-	94,853
Partner Fees		124,146	129,587
Interest Income		404,958	318,952
		22,042,049	21,719,619
EXPENDITURE			
Project Expenditure	**1**	17,675,237	17,937,532
Administrative Expenditure	**2**		
- Administrative Operating Budget		1,816,549	1,731,469
- Supplemental Budget		1,946,671	1,483,183
New Building Fund		-	94,853
		21,438,457	21,247,037
NET SURPLUS	**3**	603,592	472,582

There are no recognised gains or losses other than the results for the year as set out above.

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE

BALANCE SHEET AT 31 DECEMBER 2004

	Note	2004 USD	2003 USD
CURRENT ASSETS			
Receivables			
Amounts due from funding parties	**5**	6,561,908	9,094,008
Other receivables	**6**	26,237	44,306
Prepayments and accrued income	**7**	80,362	42,776
Cash and cash equivalents		41,143,759	37,379,117
		47,812,266	46,560,207
CURRENT LIABILITIES			
Amounts payable – projects	**8**	(2,317,981)	(2,688,795)
Amounts payable – non-project		(236,715)	(187,803)
		(2,554,696)	(2,876,598)
TOTAL ASSETS LESS LIABILITIES		45,257,570	43,683,609
CAPITAL CONTRIBUTIONS			
Designated capital – projects	**9**	20,916,901	22,348,183
Designated capital – administration	**10**	1,959,358	1,726,214
Designated capital – supplemental	**11**	4,660,357	4,382,932
Undesignated capital	**12**	17,720,954	15,226,280
		45,257,570	43,683,609

Signed on behalf of
The Science and Technology Center in Ukraine 6 MAY **2005**

Andrew A. Hood –Executive Director

Curtis M. Bjelajac – Chief Financial Officer

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE

STATEMENT OF CASH FLOWS AT 31 DECEMBER 2004

	Note	2004 USD	2003 USD
Cash Flows from Operations			
Cash Inflows			
Net Cash Received from Funding Parties	**13**	24,913,683	19,573,829
Interest Income and Partner Fees Received		487,134	456,894
Total Cash Inflows		25,400,817	20,030,723
Cash Outflows			
Project Expenditure		(18,046,051)	(16,467,892)
Administrative and Supplemental Expenditure		(3,590,124)	(3,281,855)
Total Cash Outflows		(21,636,175)	(19,749,747)
Net Cash Inflows From Operations		3,764,642	280,976
Cash and cash equivalents at 1 January		37,379,117	37,098,141
Cash and cash equivalents at 31 December		41,143,759	37,379,117

1. Project Expenditure

	USD
Amounts charged to the Statement of Revenues and Expenditure:	
2004	17,675,237
2003	17,937,532
2002	12,317,194
2001	10,100,633
2000	7,096,198
1999	7,904,566
1998	7,351,641
1997	4,987,540
1996	1,339,245
1995	-
Cumulative project costs incurred to 31 December 2004	86,709,786

Project expenditure comprises of grants to scientists, equipment costs, travel costs and overhead costs.

Under the terms of the individual project agreements signed, title to equipment costing less than 2,500 USD is vested with the recipient institutes upon acquisition. The title to all other equipment provided to projects will remain with the Center until termination or completion of the project at which time the title will be vested in the recipient institutes unless prior to or on that date the Center informs the project of its intention to retain title.

2. Administrative Expenditure

	2004 USD	2003 USD
a) Administrative Operating Budget		
Business Operations	282,685	334,611
Public Affairs	39,130	52,651
Personnel	646,432	603,006
Personnel Support and Development	118,749	123,590
Sustainability Group Operations	79,929	62,166
Legal, Auditing, and Banking	271,654	262,748
Fixed Assets	145,051	82,188
Headquarters and Branch Offices	232,919	210,509
	1,816,549	1,731,469

Included within ‘Legal, auditing and banking’ are exchange losses of 12,050 USD (2003 - 9,605 USD).

Personnel costs comprises grants made to the grantees in the STCU headquarters and six regional offices located in Lviv, Kharkiv, Dnipropetrovsk, Baku, Tashkent and Tbilisi.

	2004 USD	2003 USD
b) Supplemental Budget		
Technical, Collaborator and Contractor Travel Support	36,196	95,572
Information Technology Support	51,458	45,185
Communication Support	2,555	-
Business Training/ Sustainability Group Support	19	67
Patent Support	23,335	14,185
Travel and Mobility Support	210,870	214,101
Expert Review and Advisors	27,609	9,182
Seminars/ Workshops Support	86,034	36,523
Service Contracts	1,508,595	1,068,368
	1,946,671	1,483,183

3. Net Surplus Revenues Over Expenditure

The net surplus of 603,592 USD comprises the following;

	2004 USD	2003 USD
Surplus Administrative Budget Revenues	76,109	18,161
Investment Income	404,958	318,952
Partner Fees	124,146	129,587
Other Revenue/(Expense)	(1,621)	5,882
	603,592	472,582

The net surplus set out above has been allocated to the Funding Parties in accordance with the accounting policies and agreed responsibilities.

4. Taxation

Under the terms of the agreement establishing the STCU and also the Statute approved by the Board of Governors, the STCU is exempted from any form of taxation. However, only since December 1999 has the relevant legal framework been implemented in Ukraine, allowing the STCU to recover its VAT on Administrative expenditures.

The VAT incurred on project expenditures has been charged to the Statement of Revenues and Expenditure as part of the project costs because, for the time being there is no practical process in place for the recovery of VAT for project purchases within Ukraine, Georgia, Uzbekistan, and Azerbaijan. Management of the STCU continues discussions with the Governments of Ukraine, Georgia, Uzbekistan, and Azerbaijan to investigate the possibility of establishing a procedure to recover project VAT for purchases made within these respective countries. However, the management of the STCU does not expect to recover the amounts incurred to date.

Accordingly the VAT incurred on project expenditures has been charged to the Statement of Revenues and Expenditure as part of the project costs. Project items purchased abroad by the STCU and imported into Ukraine, Georgia, Uzbekistan, and Azerbaijan are exempt from VAT.

The VAT on administrative expenditures for 2004 has been credited back to the corresponding expense account to which it relates.

5. Amounts Due from Funding Parties – Due Within One Year

	2004 USD	**2003 USD**
United States	2,370,527	2,147,035
Canada	233,372	229,222
European Union	1,164,132	2,588,104
Partners	1,591,908	3,091,467
	5,359,939	8,055,828

Amounts Due From Funding Parties – Due After One Year

	2004 USD	**2003 USD**
European Union	625,888	579,611
Partners	576,081	458,569
	1,201,969	1,038,180
Total due from funding parties	6,561,908	9,094,008

6. Other receivables

	2004 USD	**2003 USD**
VAT Recoverable	13,968	17,052
Other Receivables	12,269	27,254
	26,237	44,306

7. Prepayments and accrued income

	2004 USD	**2003 USD**
Prepayments	24,342	21,772
Accrued Interest	56,020	21,004
	80,362	42,776

8. Amounts payable projects

	2004 USD	2003 USD
Grants Payable	1,475,083	1,900,822
Overhead Payable	234,828	228,397
Overhead Retainage	608,070	559,576
	2,317,981	2,688,795

9. Designated Capital Contributions - Projects

Designated Capital Contributions represent the amounts committed on signed projects net of project expenditures incurred to date.

	United States	Canada	Japan	European Union	Partners	Total
	USD	USD	USD	USD	USD	USD
Balance at January 1, 2004	9,634,007	366,306	-	4,567,134	7,780,736	22,348,183
New Projects Signed During 2004	7,660,992	185,772	145,000	4,235,033	4,054,958	16,281,755
2004 Adjustment	-	-	-	-	(30,736)	(30,736)
Revaluation of Project Agreements	-	-	-	369,329	48,035	417,364
Adjustment for Terminated Projects	-	-	-	-	(218,629)	(218,629)
Adjustment for Closed Projects	(29,093)	(716)	-	(13,577)	(162,413)	(205,799)
Transfer to Statement of Revenues and Expenditure						
Expenditure Incurred on Projects in 2004	(8,179,659)	(270,910)	(55,015)	(4,037,307)	(5,132,346)	(17,675,237)
Balance at December 31, 2004	9,086,247	280,452	89,985	5,120,612	6,339,605	20,916,901

10. Designated Capital Contributions - Administration

	United States	Sweden	Canada	European Union	Partners	Ukraine	Total
	USD	**USD**	**USD**	**USD**	**USD**	**USD**	**USD**
Balance at January 1, 2004	1,105,172	-	186,326	434,716	-	-	1,726,214
Additional Contribution for 2004	-	-	-	-	-	164,823	164,823
Transfer to Statement of Revenues and Expenditure	(1,105,172)	-	(186,326)	(434,716)	-	(164,823)	(1,891,037)
Administrative Budget 2005	1,270,885	-	196,492	491,981	-	-	1,959,358
Balance at December 31, 2004	1,270,885	-	196,492	491,981	-	-	1,959,358

11. Designated Capital Contributions - Supplemental

	United States	Sweden	Canada	European Union	Partners	Ukraine	Total
	USD	**USD**	**USD**	**USD**	**USD**	**USD**	**USD**
Balance at January 1, 2004	3,043,641	103,695	35,958	985,779	213,859	-	4,382,932
Supplemental Budgets Approved	1,566,693	-	71,623	483,876	85,000	-	2,207,192
Transfer from Undesignated Capital Contributions	-	505	-	-	-	-	505
Adjustment for Revaluation	-	-	-	16,399	-	-	16,399
Transfer to Statement of Revenues and Expenditure	(1,362,228)	(4,656)	(24,975)	(509,097)	(45,715)	-	(1,946,671)
Balance at December 31, 2004	3,248,106	99,544	82,606	976,957	253,144	-	4,660,357

12. Undesignated Capital Contributions

	United States	Sweden	Canada	Japan	European Union	Partners	Other	Total
	USD	USD	USD	USD	USD	USD	USD	USD
Balance at January 1, 2004	11,336,810	-	-	373,417	792,987	2,804,718	(81,652)	15,226,280
Advances Received from Funding Parties	9,950,259	-	-	-	5,368,498	2,496,743	-	17,815,500
Transfer to Designated Capital for Signed Projects	(7,660,992)	-	-	(155,150)	(2,500,973)	(1,021,036)	-	(11,338,151)
Adjustment for Closed Projects	29,093	-	716	-	13,577	162,413	-	205,799
Allocation of Surplus Income for 2004	465,954	505	33,895	2,691	103,742	-	-	606,787
Adjustment for 2004 Other Purposes	7,355	-	132	-	406	33,272	(1,621)	39,544
Adjustment for Revaluation	-	-	-	-	278,825	-	-	278,825
Transfers to ISTC	(1,000,000)	-	-	-	-	(746,770)	-	(1,746,770)
Transfer to A/P Non-Projects	-	-	-	-	-	(6,780)	-	(6,780)
Transfer to Designated Capital – Supplemental Budget	(1,413,098)	(505)	-	-	(198,003)	(57,000)	-	(1,668,606)
Transfer to Designated Capital - Administrative Budget	(1,200,980)	-	(34,743)	-	(455,751)	-	-	(1,691,474)
Balance at December 31, 2004	10,514,401	-	-	220,958	3,403,308	3,665,560	(83,273)	17,720,954

Note : The amount of 1,621 USD under 'Other' relates to the performance of the 2003 and 2004 audit. This amount is a timing difference between when the audit cost is accrued as an expense for financial statement purposes, and when the amount is accounted for in the Administrative Operating Budget. The audit cost is expensed in the year before it is included in the AOB. Thus, the 2004 audit cost is accrued as an expense in the 2004 Fiscal Year Financial Statements; however, the cash disbursement will affect the 2005 AOB.

13. Net cash received from funding parties

	2004 USD	2003 USD
Canada	414,994	400,685
Sweden	-	-
Ukraine	56,138	159,980
Partners	6,019,104	6,451,430
United States	8,956,524	7,765,580
European Union	9,466,923	4,796,154
Japan	-	-
	24,913,683	19,573,829

14. Financial commitments

a) **Science and Technology Center in Ukraine**
No material commitments existed at December 31, 2004.

b) **Funding parties**
At December 31, 2004 the funding parties had approved but not signed 31 projects with a total funding of 4,245,230 USD (2003 - 10,243,707 USD). The agreements for these projects are expected to be signed in 2005. As a result of political unrest in Ukraine at the end of 2004, the 19th STCU Governing Board meeting scheduled to be held on December 2, 2004 in Kyiv, was postponed until February 10, 2005, at which time the funding parties approved but not signed 25 projects with a total funding of 2,544,835 USD and 775,000 Euro (equivalent to 1,057,410 USD at December 31, 2004).

15. Expenditures borne directly by funding parties

Under the terms of the various agreements by which the funding parties set up the Science and Technology Center in Ukraine, certain executive and senior staff salaries are borne by the funding parties.

16. Financial Instruments

The STCU’s financial instruments comprise:

- Cash, liquid resources and short term debtors and creditors that arise directly from the STCU’s operations.

These financial instruments are initially recorded at their nominal value and are stated in the accounts at their nominal value reduced by appropriate allowances for estimated irrecoverable amounts.

The main risks arising from the STCU's financial instruments are liquidity risk and foreign currency risk. The STCU management reviews and agrees policies for managing each of these risks and they are summarised below.

a) Liquidity Risk
The STCU's assets comprise mainly of cash and bank deposits which are readily realisable to meet funding commitments.

b) Foreign Currency Risk
The STCU's income and expenditure and net assets could be affected by currency translation movement as some of the STCU's assets and revenues are denominated in currencies other than USD.

At the year end, financial assets held by the STCU in currencies other than USD were as follows;

	2004		**2003**	
	Amounts due from Funding Parties USD	**Cash at Bank USD**	**Amounts due from Funding Parties USD**	**Cash at Bank USD**
Euro's	1,265,792	6,074,135	2,262,897	2,856,564
Ukrainian Hryvna	-	9,396	-	88,923
Azeri Manat	-	16		
	1,265,792	6,083,547	2,262,897	2,945,487

17. Former STCU Facility at 3 Laboratornyj Provulok, Kyiv, Ukraine, 01133

In accordance with the agreement establishing the STCU, the Government of Ukraine is responsible for providing, at its own expense, a facility suitable for use by the Center, along with maintenance, utilities and security. Accordingly the premises at 3 Laboratornyj Provulok were rented and made available to the STCU at the commencement of the STCU's activities.

Because the ownership of the STCU's former facility was unclear, the Ministry of Foreign Affairs stopped all rent payments until suitable ownership documents could be presented by the landlord. The rent from January 1, 2000 to May 31, 2000 (53,000 USD) was not paid.

In late January 2002 the landlord obtained an ownership document for the former facility. During the course of 2002, the Government of Ukraine attempted to negotiate with the landlord of the STCU's former facility, in order to resolve two issues:

(1) the unpaid rent from January 1, 2000, and
(2) a new long-term lease for the STCU in the former facility.

In early October 2002, with no agreement reached between the former landlord and the Government of Ukraine on either of the aforementioned issues, the former landlord interrupted the electricity supply to the STCU's former facility. As per the decision of the STCU Board of Governors related to any interruption in STCU utilities, the Executive Director of the STCU declared "force majeure" (as described in Note 1) and the STCU moved into a temporary facility in mid-October 2002. The STCU returned the keys and the control of the former facility to the former landlord at the end of November 2002 and moved into its new premises at 21 Kameniariv, Kyiv in late December 2002.

On April 25, 2003, the former landlord filed suit (case #89-04/03) against the STCU and the Ministry of Foreign Affairs of Ukraine (as a co-defendant) in the Civil Court of the City of Kyiv in the amount of 318,848.17 UAH (59,804.59 USD) for unpaid rent at the STCU's former premises. On June 26, 2003, (decision #3/335) the court found in favour of the former landlord and against the STCU, but not the Ministry of Foreign Affairs of Ukraine.

On April 6, 2004, the former landlord collected 968.25 UAH (182.69 USD) of the aforementioned court award from the STCU's local bank account. As a result of this seizure of some of the STCU's funds, the STCU management decided to halt all financial operations related to Ukrainian projects, and clear the STCU's local bank accounts, until all STCU's Parties could reach agreement as to how to resolve the outstanding court award.

The Government of Ukraine, represented by the Ministry of Science and Education of Ukraine, provided 299,129.42 UAH (56,121.84 USD) to the STCU on May 7, 2004 as partial payment towards the outstanding court order. Furthermore, on May 27, 2004 the Prosecutor General of Ukraine filed a motion with the Supreme Arbitration Court of Ukraine to demand that the court decision (#3/335) in the previous case (case #89-04/03) be re-examined. This motion temporarily froze any collection activity related to decision #3/335 until the Prosecutor General's motion was ruled upon by the Supreme Arbitration Court of Ukraine. On May 27, 2004, the Ministry of Science and Education provided a written assurance to the Board of Governors of the STCU of the following: (1) that as of January 1, 2003 the Ministry of Science and Education is the branch of the Government of Ukraine responsible for the STCU, (2) that the Ministry of Science and Education will uphold Articles 9 and 11 of the Agreement to Establish the STCU related to the Government of Ukraine providing at its own expense, a facility including all payments of rent and communal services, and (3) that the Ministry of Science and Education guarantees to assume the protection and obligations of the STCU in case of the filing of any court case or legal claims by Ukrainian citizens or organizations against STCU, in particular, case No. 3/335 of the Civil Court of Kiev.

On July 2, 2004, as a result of the Prosecutor General of Ukraine's motion with the Supreme Arbitration Court of Ukraine, Solominsky District Court cancels the court decision #3/335.

On July 9, 2004, the Civil Court of Kyiv issues letter stating that a new case will be opened with the case #3/335-2/308, within which the STCU will be named as a defendant, along with the Cabinet of Ministers (instead of the Ministry of Foreign Affairs as stated previously in case #3/335).

In late July, 2004, the Government of Ukraine and the STCU agree to lodge a counter-claim against the STCU's former landlord, requesting repayment of rent and renovations paid by the STCU up until the date of documented ownership (December, 2000) by the STCU's former landlord. The amount of the counterclaim was 852,496.30 UAH (159,943.02 USD).

On November 12, 2004, the Supreme Arbitration Court of Ukraine provided a final verdict on both the original claim of the STCU's former landlord and the counterclaim advising that the court had declined to satisfy any claim from either party stating that the term of term or statute of limitation (counting from the initial lease signing date on May 26, 1995) had expired. The court provided 10 days for both sides to appeal. Neither side lodged an appeal. Thus, according to STCU's legal advisors, this seemingly constitutes a draw and unless either party decides to lodge a new case, the court decision (#3/335) in the previous case (case #89-04/03) is closed.

Finally, according to STCU's legal advisor's, the STCU's former landlord has until October 2005 to start a brand new case against the STCU before the statute of limitations on the period of unpaid rent expires. At that point in time, the STCU's former landlord should have no legal recourse to recover funds for upaid rent at the STCU's previous facility.

With these Ukrainian Court actions and written assurances by the Ministry of Science and Education on behalf of the Government of Ukraine and having regard to the Agreement establishing the STCU, the management of the STCU believes that it is not liable for unpaid rent and utilities of its former premises located at Laboratornyj Provulok 3. Accordingly, the financial statements do not include any provision for the unpaid rent and utilities of the STCU's former facility.

LUBBOCK FINE

CHARTERED ACCOUNTANTS

SCIENCE AND TECHNOLOGY

CENTER IN UKRAINE

MANAGEMENT LETTER

FOR THE YEAR ENDED 31 DECEMBER 2004

Mr A Hood – Executive Director
Mr C Bjelajac – Chief Financial Officer
Science and Technology Center in Ukraine
21 Kameniariv
03138 Kyiv
Ukraine

Dear Sirs

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE
FINANCIAL AUDIT FOR THE YEAR ENDED 31 DECEMBER 2004
MANAGEMENT LETTER – EXECUTIVE SUMMARY

I. Introduction

We have now completed our audit of the financial statements of the Science and Technology Center in Ukraine (STCU), based in Kyiv, Ukraine, for the year ended 31 December 2004.

Our audit was performed in accordance with internationally recognised Auditing Standards. In planning and performing our audit we have considered the STCU's internal control structure in order to assess the level and nature of auditing procedures for the purpose of expressing an opinion on the financial statements.

In conjunction with our review of internal controls in place for the financial year ended 31 December 2004 we have also reviewed the Management Letter which we prepared for the year ended 31 December 2003, to ascertain whether the weaknesses identified in 2003 still exist in 2004.

In general we have noted that a number of improvements have been made by the STCU in the internal control and recording of transactions, however a number of weaknesses still exist where controls and procedures can be improved. Of the 8 Observations noted last year, 3 have been addressed and are no longer considered to be an issue. The remaining 5 Observations are still considered to be of significance and require some form of corrective action, although we would point out that in relation to some of these issues improvements have been made. The outstanding matters not yet resolved are all referred to in the body of this letter.

Please find below a summary of the observations, full details of which are set out in section II of the report. These observations were discussed with Curtis "B.J." Bjelajac prior to written comments being obtained, which are incorporated in this report.

II. Observations Summary

1. The use of two software packages, ACCPAC (a dedicated accounting package) and ACCESS (a database package tailored

for STCU's needs) to record financial transactions limits the availability of financial information.

We now note that this issue, which has been raised at the last four audits, is now being addressed and an agreement has been reached with a company for the supply of a fully integrated accounting and reporting software package, with its implementation likely to happen in the second half of the year. (See Observation No.1).

2. We noted that there was no bonding insurance for the transportation of large amounts of cash from First Ukrainian International Bank to the STCU. (See Observation No.2).
3. During the course of our review we noted that a number of contracts concluded with the project beneficiaries were not dated by all signatories of the contract. (See Observation No.3).
4. It was noted that some 42 scientists had claimed grants for more than the permitted 220 days per year. (See Observation No.4).
5. In relation to the technical and financial audits carried out by the USDCAA, it was noted that a number of issues were raised regarding the completion of time cards by participants. In addition issues were raised regarding the identification of project equipment and the verification of time inputs to documentary evidence for one participant. (See Observation No.5).
6. During the course of our review we noted there was no one system for the filing of project invoices. This impairs the efficiency of tracing expenditure back to invoices. (See Observation No. 6).
7. It was noted that the posting of accruals for working cash at the year end was incorrectly carried out. The method used understated working cash and accruals at the year end. (See Observation No. 7).

This report has been prepared for the sole use of the Board of Governors and the Management of the Science and Technology Center in Ukraine and must not be shown to third parties without prior consent. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.

Yours faithfully

Lubbock Fine

12/5/08

TABLE OF CONTENTS

I. AUDIT FINDINGS SUMMARY

AUDIT FINDINGS SUMMARY

Item No.	**Title**	**STCU Comments (Agreed or Not Agreed)**
1.	The use of two software packages for the maintenance of financial information.	**Agree**
2.	Lack of adequate insurance cover.	**Agree**
3.	Contracts not dated.	**Partially Agree**
4.	Monitoring of grant payments.	**Agree**
5.	Technical and financial monitoring of projects	**Agree**
6.	Filing of invoices for project expenditure	**Agree**
7.	Method of treating accruals for working cash expenditure	**Agree**

II. AUDITOR'S REVIEW

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 1

Title: The use of two software packages for the maintenance of financial information.

Description: Currently the STCU uses two different, independent, software packages for the preparation and monitoring of financial information. The principal package used for the preparation of the financial statements is ACCPAC, a recognised, off the shelf, accounting package. The second package, ACCESS, is a database that has been tailored to the needs of the STCU, primarily for the monitoring of project activity.

As a general rule ACCESS is used for the day to day entry of transactions relating to the projects. Specifically, the payments relating to project expenditure are all recorded in ACCESS on a daily basis. New procedures have been adopted by the STCU to record all project transactions on ACCPAC on a monthly basis, ensuring that more accurate information is available and is reviewed throughout the year.

Whilst the ACCESS system developed by the STCU is a powerful tool for monitoring purposes, it is not an accounting package, and accordingly there are limitations in the manner in which financial information can be produced. The problems associated with extracting financial information from ACCESS, and the lack of interaction or integration with ACCPAC are detailed below.

(i) ACCESS acts primarily as a database, and is not an accounting package. As such it does not have the capacity to generate reports that would be associated with a more familiar accounting package. This particularly applies to accounts payable where a standard accounting package would generate reports indicating what liabilities of the organisation are due, when the liability was due, and break it down to components.

The inability to generate reports then prevents an effective review of the figures to be undertaken. This then has the effect of obvious errors not being spotted and rectified.

(ii) The use of two separate systems, in the manner operated by the STCU, means that certain data is entered twice, which is not the most effective use of resources.

Recommendation: It is our understanding that the primary reason for the reliance on ACCESS for the posting of day to day payments, was the dissatisfaction of using the job cost module on ACCPAC. We are further aware that STCU now has an in-house IT department which will take more control over ACCESS and that the system is in the process of being documented.

We accept that there are advantages of using ACCESS for project management, and that for the short term changes have been made to the current system.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 1

The short-term considerations included in the management letter for the years ended 31 December 2000 to 2003 have now, in the main been, been implemented. For example, the STCU are in the process of documenting the system and are increasing the involvement of the IT department in the control of ACCESS. Also project transactions are now entered onto ACCPAC monthly.

In the longer-term, we are aware that the STCU has now entered in to an agreement with a software company to provide an integrated accounting package which will cater for the various needs of the STCU. This package is due to be operational in late 2005, and therefore the observations noted above will continue to be an issue for a short while yet.

STCU Comment: The STCU concurs with Lubbock Fine's recommendations. As mentioned, the STCU management plans to focus primarily on performing the steps necessary to address the long-term systems issues. The STCU management has accomplished in 2004 and plans to perform the following long-term steps in 2005 to address this observation:

(i) In November 2004, the project team underwent training on Navision in order to get a better understanding of the system and its functionality. During this period, the project team discussed preliminary design issues related to the implementation.

(ii) In December 2004, the STCU Board of Governors approved the remaining funds required for the purchase and implementation of Navision.

(iii) In the second-half of December 2004, the STCU signed the software agreement for the purchase of Navision and remitted payment.

(iv) In May 2005, the STCU is scheduled to sign the consulting agreement with Innoware (the winner of the tender) for the implementation of Navision.

(v) At the end of May 2005, the STCU is scheduled to "kick-off" the implementation of Navision with a scheduled "go live" date of Aug. 31, 2005.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 2

Title:	Lack of adequate insurance cover.
Description:	During our examination of insurance costs, it was found that the current insurance cover of the STCU is insufficient to safeguard its assets in one key respect. We noted in the management letters for the years ended 31 December 1999 to 2003 that there was no bonding insurance for the transportation of cash from the First Ukrainian International Bank to the Center. We now note the STCU pays all STCU local employees by bank transfer and travel advances for less than US$3,000, and as a result the volume of cash being withdrawn and transported at any one time has been significantly reduced as has the frequency of withdrawals. We are also aware of the fact that armed security guards now accompany the treasurer when withdrawals of cash are made. We would point out that the STCU has attempted to obtain insurance cover, however as yet it has been unable to find a suitable cover.
Recommendation:	Whilst we acknowledge that the issue of insurance cover is problematic in Ukraine, and the fact that the STCU has attempted to obtain cover, we strongly recommend further investigation be carried out in order that such cover can be obtained.
STCU Comment:	The STCU concurs with Lubbock Fine's recommendation, and will continue to try and identify additional insurance providers that might provide quotes for a reasonable policy. If a reasonable quote is found, the STCU will utilize the funds provided for this coverage in the Administrative Operating Budget to secure adequate insurance for this issue.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 3

Title: Contracts not dated.

Description: In the management letters for the years ended 31 December 1999 to 2003 we noted that in the majority of cases, contracts concluded with project beneficiaries were not dated by all parties.

During the course of our audit it was noted that in some cases, the contracts are still not being dated. However, we would point out that this issue relates primarily to the institutes not dating contracts, and in some instances project partners, the STCU was noted to have dated all contracts.

As well as not being in accordance with standard business practice, the issue of not dating contracts creates a further difficulty with respect to capital accounts. The accounting policy of the STCU states that a project becomes designated when the contracts are signed. If all participants do not date the contract, then the accounting policy becomes harder to implement, and increases the risk that capital may be wrongly credited to either designated or undesignated project capital.

Whilst we have noted improvements in this respect since this issue was first noted in the management letter for the year ended 31 December 1999, there were still instances during the year where the contracts were not dated by some of the parties.

Recommendation: All contracts must be dated by all signatories. The project accountant must check that the contract is signed and dated by all parties, before releasing any monies to the institute under the contract.

STCU Comment: The STCU partially concurs with Lubbock Fine's recommendations, and will continue to work to ensure that all contracts are dated by instructing the STCU Senior Specialists to work with all parties (e.g. lead institutes, participating institutes, and partners) to ensure that they date their signatures . The STCU agrees that the dating of signatures is standard business practice. However, the STCU must weigh the interest of the Parties to see the project agreements signed in a timely manner in order to meet their non-proliferation goals, versus teaching and enforcing a Western standard business practice. Dating signatures was not a general business practice in the former Soviet Union, which hampers the STCU in its efforts to teach the institute directors this Western business practice. Thus, in summary, although the STCU agrees that the dating of signatures is a very good practice, it will not return those contracts not dated by the signatory parties, because this will slow down even more an already lengthy process of starting an STCU project. The STCU feels that any further delays in the starting of STCU projects would be detrimental to the aforementioned non-proliferation goals of the Parties.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 4

Title: Monitoring of grant payments.

Description: As part of our review of the project costs incurred during the year we attempted to ascertain whether any of the scientists or support personnel receiving grants had claimed for more than 220 days a year, which is deemed to be a normal working year.

The STCU generated a report from ACCESS showing individuals who worked for more than 220 days in the year ended 31 December 2004 and also showing rolling 12 month totals for each month. This report indicated that some 42 (2003 – 14) scientists had claimed for more than the permitted 220 days, with a total of 816 (2003 – 525) days being potentially being claimed in excess of this limit.

Of particular concern was Mineev who claimed to be working 16 hours a day for the whole of April and May 2004 (on 2 separate projects).

Whilst STCU has the ability to run a report showing individuals who work more than 220 days in a year, this is done retrospectively at the end of each quarter. At present no action is taken to prevent the scientists from exceeding this limit in the future.

In addition, we noted that the requirement for scientists to work no more than 220 days per year on STCU-funded projects is not included in the agreement between the individual scientists and STCU. It is therefore possible that the scientists are not aware of this requirement and this increases the likelihood that scientists will exceed this limit.

In relation to the issue of the 220 working days per year, which is used as a benchmark by the STCU, we believe that this figure is low, and does not fully reflect the reality of the STCU projects. In addition the situation is further complicated with regard to partner projects where there seem to be less restrictions on the working days rule, for instance a grantee working 12 hours in a day is able to claim 1.5 days (based on an 8 hour standard day).

We note that as of 1 March 2005 the STCU clarified the situation by specifying an upper limit on days worked per year of 220. This limit can be extended to 242 days upon written approval of the STCU.

Recommendation: We would make the following recommendations;

(i) In relation to the 42 scientists already identified, and in particular Mineev, we would recommend that the STCU undertakes a thorough review of the grants claimed by these individuals. This will involve identifying all of the projects that they have worked on and then obtaining copies of their time sheets for these projects. The time sheets should then be compared and any duplications identified.

If duplications are identified, steps should be taken to recover the grants that the individuals were not entitled to.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 4

If no duplication occurred and the scientists genuinely worked the amount of days claimed, STCU should write to the scientists reminding them of the 220 day limit and requesting that they keep better control over the number of days they work in the future.

(ii) In order to ensure that such exceptions do not occur in the future, any exceptions noted when the number of days worked is reviewed should be followed up with the scientists concerned.

As a further measure the finance department should ask the Senior Specialists to report to them instances where they believe that certain individuals are claiming more grants than they are entitled to.

(iii) The agreement between STCU and the individual scientists should be amended to include the requirement that the scientist may not work for more than 220 days per year on STCU funded projects and that this may be increased to 242 days upon the written approval of the STCU. The agreement should also stipulate the requirement to calculate this total on a rolling basis.

STCU Comment: The STCU concurs with Lubbock Fine's recommendations, and will implement the recommendations presented in the following manner:

(i) The STCU will conduct a thorough review of the time cards of those 42 scientists identified in order to ensure that there are no occurrences of payments made for duplicate time worked on multiple projects. If duplication is found to have occurred, then the STCU will take appropriate action. If no duplication is found, then the STCU will send a letter to the scientists, with a copy to the appropriate Project Managers and Institute Directors of the projects associated with these scientists, informing them of the situation and requesting them to ensure that there is no reoccurrence of this issue in on-going and future projects.

In the case of Mr. Mineev, the STCU wrote a letter dated March 18, 2005 to Mr. Mineev, as well as the two project managers associated with the projects that he worked on claiming 16 hours per day, asking Mr. Mineev to substantiate the hours claimed on his timecards. On March 23, 2005, the STCU received e-mail responses to the STCU's written letter within which Mr. Mineev and the two project managers associated with the projects charged with the time worked, substantiated the time worked by Mr. Mineev in manner acceptable to the STCU. In short, because of time constraints on both projects, as well as Mr. Mineev's key role on both, he was forced to work substantial overtime hours in order to achieve the deliverables in the timeframes required in the two project workplans. Both project managers reiterated that Mr. Mineev did indeed work the hours indicated in his timecards. .

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 4

(ii) The STCU worked closely with the ISTC to review and incorporate its policy in this matter. As a result of the discussions with the ISTC, the STCU developed a policy (entitled "SOP XXIV - Poject Participant Participation in STCU Projects") within which the STCU allows project participants to work up to 242 days within one rolling calendar year with the permission of the senior specialist, and stipulates courses of action for those participants who work more than 242 days.

(iii) As was noted above, in the past when the STCU discovered that a scientist worked more than 220 days in a rolling calendar year, the STCU generated a warning letter to the project participant with a cc: to the project manager. With the newly implemented (effective as of March 1, 2005) policy mentioned above, the STCU will allow project participants to work more than up to 242 days with the permission of a senior specialist. In addition, the STCU project accountants will increase their cooperation with senior specialists in order to better prevent scientists from claiming grants not due to them.

(iv) In 2004, the STCU amended the agreement between the STCU and the project participants to include the statement that the project participant may not work for more than 220 days per year on STCU funded projects, calculated on a rolling calendar year basis. Thus, the STCU will update the agreement again in 2005 to incorporate the details outline in the newly developed policy described above.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 5

Title: Financial and Technical monitoring of projects

Description: At the request of the U.S. Department of State, the STCU recently completed 11 U.S. sponsored technical and financial project audits. The STCU worked closely with the U.S. D.O.S., Defense Contract Audit Agency, and a select group of technical auditors to perform integrated financial and technical audits.

In relation to these audits the following issues were noted:

(a) In relation to Projects 1538, 1556 and Uzb-39 (J) it was noted that participants were not completing their timecards properly, either because the timecards were not completed on the day of the work, they were being filled out in advance or they were potentially being completed by other people.

(b) In relation to Project Uzb-39 (J) it was noted that institute directors were claiming more hours than permitted by STCU regulations.

(c) In relation to Project P115 the USDCAA noted that there was insufficient documentary evidence to verify the work carried out by a particular project participant.

(d) In relation to Projects 1538, 1556, 1700, 1580 and 1766 the USDCAA has raised an issue concerning the overclaim of overhead costs resulting from the inclusion of VAT in total project costs.

According to the project agreements, overheads are to be charged at a fixed % of total allowable costs. At present projects claim overheads on the total costs, however according to the USDCAA, VAT is not an allowable expense and should therefore be deducted from the total project cost before calculating the overhead payable. On this basis the USDCAA has calculated that a number of projects have been overpaid overhead costs because of the inclusion of VAT in the calculation.

We would point out that in general the level of overpayment is very small, and it should be borne in mind that it has always been the practice to include VAT as there is no practicable mechanism to recover the VAT from the authorities.

Recommendation: In relation to the above we would make the following recommendations:

(a) With regard to the completion of the time cards we would recommend that the STCU reminds all project managers, at the various projects, of the manner in which time cards should be completed. The project managers should in turn be required to reiterate the procedures to the individual participants.

(b) Overclaim of hours by institute directors we recommend the STCU carry out procedures as described under observation number 4

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 5

regarding the monitoring of grant payments.

(c) In relation to the individual project participant the STCU should request the individual to present appropriate documentary evidence to the project manager at the STCU to determine whether the work carried out was in agreement with the amount of time claimed.

(d) With regard to the issue of excess overheads being claimed due to the inclusion of VAT in project expenditure, we would recommend that either the STCU develops a mechanism to recover the excess VAT or it amends the project agreements to ensure that the VAT element is allowable.

STCU Comment: The STCU concurs with Lubbock Fine's recommendations and plans to perform the following steps to address this observation:

(i) The STCU will require all senior specialists and project accountants to reinforce to all project participants of all projects including 1538, 1556 and Uzb-39 (J) the requirements of Article 8.1.7. (b) Annex II General Conditions, Part C (Allowable Costs) of the Model Project Agreement, which states the following: "Individual participants must personally complete their time cards each day and in ink, and must sign their own time cards at the end of each month.". Furthermore, the STCU will require all senior specialists and project accountants to reinforce to all project managers and participating institute managers of all projects including 1538, 1556 and Uzb-39 (J) the requirements of Article 8.1.10. (c) Annex II General Conditions, Part C (Allowable Costs) of the Model Project Agreement, which states the following: "ensure that individual participants correctly record the hours worked on this project according to the procedure described in Article 8.1.7.". Again, this reinforcement will occur throughout the year when project managers bring in their project's monthly timecards, as well as during the regularly scheduled STCU monitorings. Particular emphasis will be placed on time card procedures and policies during the first monitoring, which as per STCU Standard Operating Procedure VIII – Project Monitoring Policy is scheduled to occur within the first six months of the operative commencement date of the project. Furthermore, The STCU will develop a standard training program for project managers and participants in order to inform them about the changes to procedures brought about by the installation of Navision (scheduled for implementation in late summer '05), and will include a section about the requirements related to timely and accurately completion of their timecards.

(ii) The STCU will require all senior specialists and project accountants to reinforce to all recipient signatories, deputy

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 5

recipient signatories, and project managers of all projects, including Uzb-39, the requirements of Article F of STCU Standard Operating Procedure VI – Project Financing.

Furthermore, in the case of Uzb-39, the STCU followed up on DCAA's recommendation and secured the appropriate request for increased participation of the institute director from the project, which the STCU approved on in January 2005. A copy of this request with appropriate approval signatures is set out in Annex 1 to the Management Letter.

(iii) In the case of the project participant on project P115 without satisfactory documentation to substantiate his hours on the project, the STCU followed up on DCAA's recommendation and sent a letter to the project manager emphasizing the importance of maintaining timely and accurate documentation. A copy of this letter is set out in Annex 2 to the Management Letter.

Furthermore, this matter will be reviewed again by a Senior Specialist during the final monitoring of this project.

(iv) The STCU still views the recovery of STCU VAT as the ultimate resolution to this observation, and will continue its efforts to work with the recipient party governments to recover these funds. At the same time, the STCU worked closely with the management of the ISTC in July 2004 to clarify how the model project agreements are worded for the projects with that Center, and the STCU will modify its own model project agreement to mirror that of the ISTC's and present it to the STCU Governing Board for approval.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 6

Title:	Filing of invoices for project expenditure
Description:	During the course of our audit, we noted that there was no systematic method of filing of project invoices. This caused difficulties in the tracing of project expenditure to invoices, for a number of projects for which there was a large volume of purchases. It was noted that some of the invoices were filed by invoice date, some by payment date, and a number seemed to be filed in no logical order. This issue has become more of a problem than the past when expenditure for each project tended to be much smaller and there were far fewer invoices per project. However, projects, such as P123, which had non-labour expenses during the year of $458,767, have a much larger volume of invoices. With no consistent system for the filing of invoices it has become much more difficult to trace project expenditure to invoices.
Recommendation:	In relation to the above it is recommended that consistent policy for the filing of invoices should be adopted. This system should be designed to allow any individual to trace a purchase made from the financial records to the invoices utilising referencing and a systematic way of filing the invoices.
STCU Comment:	The STCU concurs with Lubbock Fine’s recommendations and will develop a new policy for the filing of invoices in a consistent manner, allowing the tracking of transactions from the financial records to the invoices utilized.

Audit of the Science and Technology Center in Ukraine
For the Year Ended 31 December 2004
Management Letter

Observation No. 7

Title:	Method of treating accruals for working cash expenditure
Description:	During the course of our audit we noted that an incorrect method was being applied for the treatment of accruals for working cash expenditure. At the year end, an entry was made for the total expenditure paid out of working cash in 2004 which wasn't entered into ACCPAC until the 2005 working cash replenishments, as follows: Dr Expenditure Cr Working cash The impact of this treatment was an understatement of working cash and accruals of $17,768 at 31 December 2004.
Recommendation:	At the year end, a regular accrual should be made for any expenditure incurred in the financial year which hasn't been recorded in the current year. The journal entry is as follows: Dr Expenditure Cr Accruals This accrual should be reversed at the beginning of the following year.
STCU Comment:	The STCU concurs with Lubbock Fine's recommendations, and will ensure that the recommended entry for all working cash expenditures will be utilized for the generation of the accruals for the year end December 31, 2005 financial statements.

ANNEXES

ANNEX 1

To: Deputy Executive Director
Esa Manninen
Project Coordinator
N.M. Dudko

From: Project Manager
T.F. Bekmuratov
Date: 21.01.2005.
Re: About an establishment of percent of participation N.O. Nabiev in the project

"Development of the Cryogenic-Optical Sensor for the Highly Sensitive Gravity Meters"

Project manager: Bekmuratov Tulkun Faiziyevich, Doctor of Technical Sciences, Professor
Phone: +998 71 169-1266; 162-8946 Fax:+ 998 71 162-8946
E-mail: tulkin@cyber.uzci.net, omonuz@mail.ru
Participating institution: *The Scientific Research Institute "Algorithm - Engineering" of Academy of Sciences of Uzbekistan*
Financing parties: USA
Operative commencement date: 01.AUG.2002
Project duration: 3 years
Date of submission:

Dear Esa Manninen,

In connection with necessity of the great volume works execution on creation of the new algorithms on filtration, noise compensation and modeling gravimetric gauge I ask you to resolve Nabiev Ozad Malikovich - the director of scientific research institute "Algoritm-Ingineering" 68 percent for work in the project participation. Nabiev O.M. is well- known expert on signals modeling and processing. He took part in signals processing and was the supervisor of this subject. His qualification and experience are also necessary in the software development. For the period of the project execution the duty of the director will be partialy carry out his assistant on scientific work.

Project manager
(Uzbekistan)

Professor T.F. Bekmuratov

PC agreed 14.02.05
DED 16.02.05

ANNEX 2

SCIENCE & TECHNOLOGY
CENTER IN UKRAINE

Zamira Golubenko Ph.D
Project Manager
Project #P115

February 21, 2005

Dear Ms. Golubenko,

As you are aware, representatives of the STCU, DCAA, and USDA recently audited your project, P115, "Characterization of Phytoalexins from the Malvaceae in Uzbekistan" on November 5, 2004. During that audit a number of issues were discovered and discussed with you that require corrective action on your part, as well as on the part of the project participants. The following items were discussed with you during the audit, and we would like to request again that you ensure follow up on these items in the manner described below:

- During the audit it was discovered that not all project participants were keeping timely and accurate laboratory notebooks describing the work they had completed. Thus, at the time of the audit, it was difficult for the project participants to show results of their efforts. This in turn made it very difficult for the auditors to feel comfortable that project participants were actually performing the work that they were being paid for by the STCU. As you would agree, this is not a desirable situation. Thus, please ensure that the project participants are aware that timely and accurate laboratory notebooks are not only good scientific practice, but also extremely important if your project would ever like to patent any of its work. For your information, the STCU has developed "Project Notebook Principles and Guidelines" which can be found on STCU's website at the following web address:

  http://www.stcu.int/documents/general/Lab_Notebook_Guidelines.pdf

- During the audit it was discovered that a project participant was working on a machine and processing cultures for both the institute and the STCU project, but charging all of his time to the STCU project. According to Article 8.1.10. (c) Annex II General Conditions, Part C (Allowable Costs) of the Model Project Agreement, the project manager should "ensure that individual participants correctly record the hours worked on this project according to the procedure described in Article 8.1.7.". Thus, please work with all project participants to ensure that they are completing their timecards for actual time worked on STCU projects, and not for time worked performing work required by the institute.

The STCU urges you to follow-up on these matters as soon as possible, in the manner indicated above. Furthermore, if you have any questions or comments related to this observation and follow-up actions, please feel free to contact your responsible project coordinator or project accountant. The STCU is more than happy to help clarify any questions or comments you might have.

21 Kameniariv St., Kyiv, Ukraine, 03138
tel.: +380 44 490 7150, fax: +380 44 490 7145, stcu@stcu.kiev.ua, www.stcu.kiev.ua

Furthermore, if you have any questions or comments related to the contents of this letter, please feel free to contact me directly at 380-44-490-7150. Thank you for your time and consideration.

Sincerely,

Curt "B.J." Bjelajac
Chief Financial Officer
Science and Technology Center in Ukraine

Cc: Mr. Shovkat Salikhov, Director, A.S.Sadikov Institute of Bioorganic Chemistry
Marsha Hurtado, International Affairs Specialist, USDA/ARS
Melanie Peterson, International Affairs Specialist, USDA/ARS
Andrew A. Hood, Executive Director, STCU
Borys Atamanenko, Senior Deputy Executive Director, STCU
John Zimmerman, Deputy Executive Director, STCU
Landis Henry, Deputy Executive Director, STCU
Esa Manninen, Deputy Executive Director, STCU
Peter Melnik-Melnikov, Senior Specialist, STCU
Borys Rovinsky, Project Accountant, STCU

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE - STCU
STATEMENT OF ADMINISTRATIVE OPERATING BUDGET (AOB) as of APRIL 30, 2005

	Annual Budget	Booked Expenditures	Obligated Expenses	Remaining Budget	Percentage (Over)/Under
Administrative Operating Expenses					
Non-Recurring Expenses					
FACILITY IMPROVEMENTS	10 000	0,00	0,00	$10 000,00	100,00%
FURNITURE & FIXTURES	10 000	557,85	0,00	$9 442,15	94,42%
TELECOMMUNICATIONS EQUIPMENT	13 450	7 192,54	0,00	$6 257,46	46,52%
OFFICE EQUIPMENT	10 000	7 162,99	0,00	$2 837,01	28,37%
VEHICLE PURCHASE	25 000	21 152,83	0,00	$3 847,17	15,39%
COMPUTER HARDWARE	35 700	32 305,47	0,00	$3 394,53	9,51%
COMPUTER SOFTWARE	28 445	17 653,10	0,00	$10 791,90	37,94%
Subtotal Non-Recurring Expenses	**132 595**	**86 024,78**	**0,00**	**$46 570,22**	
(1) Contingency - Non-Recurring	**25 000**	**0,00**	**0,00**	**$25 000,00**	0,00%
Recurring Expenses					
LOCAL GRANT PAYMENTS	789 000	196 760,19	0,00	$592 239,81	75,06%
REPRESENTATION	15 000	3 131,85	0,00	$11 868,15	79,12%
STAFF EDUCATION & TRAINING	63 280	13 117,38	0,00	$50 162,62	79,27%
INTERNATIONAL TRAVEL	32 400	1 592	0	30 808	95,09%
TRAVEL WITHIN THE CIS	137 615	27 444	0	110 171	80,06%
LOCAL TRAVEL	18 625	5 747,58	0,00	$12 877,42	69,14%
POSTAGE AND DELIVERY	10 000	2 521,28	0,00	$7 478,72	74,79%
CUSTOMS FACILITATION	500	178,69	0,00	$321,31	64,26%
GENERAL OFFICE SUPPLIES	23 000	10 044,74	0,00	$12 955,26	56,33%
OFFICE EQUIPMENT REPAIR/MAINT	7 000	-186,87	0,00	$7 186,87	102,67%
VEHICLE OPERATIONS	9 000	6 503,81	0,00	$2 496,19	27,74%
PRINTING AND REPRODUCTION	24 000	1 436,80	0,00	$22 563,20	94,01%
TELECOMMUNICATIONS SERVICES	40 000	9 783,24	0,00	$30 216,76	75,54%
BUSINESS MEETINGS	6 000	2 927,42	0,00	$3 072,58	51,21%
SUBSCRIPTIONS AND PUBLICATIONS	8 000	535,18	0,00	$7 464,82	93,31%
PUBLIC AFFAIRS	34 500	7 482,95	0,00	$27 017,05	78,31%
EMPLOYEE MORALE & WELFARE	22 000	5 010,77	0,00	$16 989,23	77,22%
MEDICAL PLAN	71 850	19 392,34	0,00	$52 457,66	73,01%
BUILDING SUPPLIES	7 000	3 822,88	0,00	$3 177,12	45,39%
BRANCH OFFICES	90 720	9 476,36	0,00	$81 243,64	89,55%
INSURANCE EXPENSE	9 000	2 588,11	0,00	$6 411,89	71,24%
BANK FEES - OFFSHORE	75 000	20 234,29	0,00	$54 765,71	73,02%
BANK FEES - ONSHORE	57 000	14 225,94	0,00	$42 774,06	75,04%
BUSINESS GROUP OPERATIONS	50 000	-635,17	0,00	$50 635,17	101,27%
LEGAL SERVICES	10 000	5 310,93	0,00	$4 689,07	46,89%
ACCOUNTING AND AUDITING	83 273	83 273,00	0,00	$0,00	0,00%
OTHER PROFESSIONAL SERVICES	98 000	8 322,50	0,00	$89 677,50	91,51%
Subtotal Recurring Expenses	**1 791 763**	**460 042**	**0**	**1 331 721**	
Contingency - Recurring	**10 000**	**0,00**	**0,00**	**$10 000,00**	100,00%
Total Administrative Expenses	**1 959 358**	**546 066,94**	**0,00**	**$1 413 291,06**	72,13%

SCIENCE AND TECHNOLOGY CENTER IN UKRAINE - STCU
STATEMENT OF SUPPLEMENTAL BUDGET ACTIVITY
as of April 30, 2005

Activity	Sub-Activity	Supplemental Expense	Budget	Booked Expenditures	Obligated Expenses	Remaining Budget
01	TECHNIC., COLLABOR., CONT. TRAV. SUPP,		$ 310000 + € 130000	$ 228069 + € 4497,77	$ 0 + € 0	$ 81931 + € 125502,23
	01.01	- U.S. DESIGNATED TRAVELERS	$ 310 000,00	$ 228 069,00	$ -	$ 81 931,00
	01.02	- E.U. DESIGNATED TRAVELERS	€ 130 000,00	€ 4 497,77	€ -	€ 125 502,23
02	INFORMATION TECHNOLOGY SUPPORT (USA)		$ 350 000,00	$ 168 713,79	$ -	$ 181 286,21
	02.01	- U.S.DATABASE PROJECT	$ 20 000,00	$ 20 415,38	$ -	$ (415,38)
	02.02	- STCU SERVER UPGRADE	$ 10 000,00	$ 9 808,61	$ -	$ 191,39
	02.03	- Internet Initiative in Uzb., Geo., and Ukr Pilot	$ 231 490,00	$ 138 489,80	$ -	$ 93 000,20
	02.04	- UNIDENTIFIED	$ 88 510,00	$ -	$ -	$ 88 510,00
03	COMMUNICATIONS SUPPORT (USA)		$ 332 785,00	$ 7 698,80	$ -	$ 325 086,20
	03.01	- Government of Ukraine's Registration Communication	$ 7 500,00	$ 5 143,67	$ -	$ 2 356,33
	03.02	- CASRI	$ 2 555,13	$ 2 555,13	$ -	$ -
	03.03	- UNIDENTIFIED	$ 322 729,87	$ -	$ -	$ 322 729,87
04	BUSINESS TRAINING/SUSTAIN. SUPP.		$ 575 942,00	$ 86 285,50	$ -	$ 489 656,50
	04.01	- SHARED	$ 170 772,00	$ 54 272,28	$ -	$ 116 499,72
	04.02	- US DESIGNATED	$ 400 000,00	$ 32 013,22	$ -	$ 367 986,78
		04.02.01 3 Pilot Trainings (IPR Prot, Present, Bus. Plan)	$ 38 419,20	$ 32 013,22	$ -	$ 6 405,98
		04.02.02 Pilot Internship Project	$ 25 000,00	$ -	$ -	$ 25 000,00
		04.02.03 Unidentified	$ 336 580,80	$ -	$ -	$ 336 580,80
	04.03	- EU DESIGNATED	$ 5 170,00	$ -	$ -	$ 5 170,00
05	PATENT SUPPORT		$ 268 592,00	$ 84 660,84	$ -	$ 183 931,16
	05.01	- SHARED	$ 150 000,00	$ 84 660,84	$ -	$ 65 339,16
	05.02	- US DESIGNATED	$ 100 000,00	$ -	$ -	$ 100 000,00
	05.03	- EU DESIGNATED	$ 18 592,00	$ -	$ -	$ 18 592,00
06	TRAVEL AND MOBILITY SUPPORT		$ 1 428 736,98	$ 768 219,26	$ -	$ 660 517,72
	06.01	- TRAVEL GRANT FUND (SHARED)	$ 380 000,00	$ 270 229,35	$ -	$ 109 770,65
	06.02	- U.S. DESIGNATED TRAVELERS	$ 378 000,00	$ 259 664,72	$ -	$ 118 335,28
	06.03	- E.U. DESIGNATED TRAVELERS	$ 111 676,00	$ 15 393,64	$ -	$ 96 282,36
	06.04	- PARTNER DESIGNATED TRAVELERS	$ 446 325,00	$ 209 739,84	$ -	$ 236 585,16
		06.04.01 U.S. Department of Agriculture	$ 205 000,00	$ 119 924,96	$ -	$ 85 075,04
		06.04.02 U.S. National Cancer Institute	$ 171 325,00	$ 68 886,55	$ -	$ 102 438,45
		06.04.03 U.S. Department of Energy/IPP Program	$ 70 000,00	$ 20 928,33	$ -	$ 49 071,67
		06.04.04 U.S. Environmental Protection Agency	$ -	$ -	$ -	$ -
	06.05	- SW DESIGNATED TRAVELERS	$ 104 199,86	$ 4 655,59	$ -	$ 99 544,27
	06.06	- CA DESIGNATED TRAVELERS	$ 8 536,12	$ 8 536,12	$ -	$ -
07	EXPERT CONTACT (PROGRAM RELATED)		$ 50 000,00	$ 81,90	$ -	$ 49 918,10
	07.01	- U.S. DESIGNATED TRAVELERS	$ 50 000,00	$ 81,90	$ -	$ 49 918,10
08	EXPERT REVIEW AND ADVISORS		€ 60 000,00	€ 51 960,99	€ -	€ 8 039,01
	08.01	- E.U. DESIGNATED REVIEWERS	€ 60 000,00	€ 51 960,99	€ -	€ 8 039,01
09	SEMINARS/WORKSHOPS SUPPORT		$ 322 884,00	$ 199 637,02	$ -	$ 123 246,98
	09.01	- SHARED	$ 161 800,00	$ 146 972,51	$ -	$ 14 827,49
	09.01a	- SHARED - NATO	$ 64 000,00	$ 10 826,79	$ -	$ 53 173,21
	09.02	- E.U. DESIGNATED SEMINARS/WORKSHOPS	$ 47 084,00	$ -	$ -	$ 47 084,00
	09.03	- U.S. DESIGNATED SEMINARS/WORKSHOPS	$ 50 000,00	$ 41 837,72	$ -	$ 8 162,28
10	SERVICE CONTRACTS		$ 3867340 + € 1432920	$ 2992531,63 + € 1230371,03	$ 0 + € 0	$ 874808,37 + € 202548,97
	10.01	- U.S. DESIGNATED CONTRACTS	$ 3 867 340,00	$ 2 992 531,63	$ -	$ 874 808,37
	10.02	- E.U. DESIGNATED CONTRACTS	€ 1 432 920,00	€ 1 230 371,03	€ -	€ 202 548,97
11	TARGETED R&D		$ 500 000,00	$ -	$ -	$ 500 000,00
	11.01	- SHARED	$ 500 000,00	$ -	$ -	$ 500 000,00
12	TARGETED TRAINING		$ 117 000,00	$ 13 126,98	$ -	$ 103 873,02
	12.01	- SHARED	$ 117 000,00	$ 13 126,98	$ -	$ 103 873,02
		Total Supplemental Expenses	$ 8 123 279,98	$ 4 549 024,72	$ -	$ 3 574 255,26
			€ 1 622 920,00	€ 1 286 829,79	€ -	€ 336 090,21