

**LUBBOCK FINE  
CHARTERED ACCOUNTANTS**

**SCIENCE AND TECHNOLOGY**

**CENTER IN UKRAINE**

**MANAGEMENT LETTER**

**FOR THE YEAR ENDED 31 DECEMBER 2009**

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.

20 May 2010

Mr A Hood – Executive Director  
Mr C Bjelajac – Chief Financial Officer  
Science and Technology Center in Ukraine  
7A Metalistov Street  
03057 Kyiv  
Ukraine

Dear Sirs

**SCIENCE AND TECHNOLOGY CENTER IN UKRAINE  
FINANCIAL AUDIT FOR THE YEAR ENDED 31 DECEMBER 2009  
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 2009.

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 2009 we have also reviewed the Management Letter which we prepared for the year ended 31 December 2008, to ascertain whether the weaknesses identified in 2008 still exist in 2009.

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. All of the observations noted last year 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 significant 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.

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.

LF 1525768.1

**II. Observations Summary**

1. 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.1).
2. In relation to the technical and financial audits carried out by the USDCAA, it was noted that a number of issues were raised such as unknown relationships between project participants; grantees working in excess of 220 days; procedural errors in filling out timesheets; and incorrect labelling of equipment. (See Observation No.2).
3. It was noted during the course of the audit the financial statements contain a significant amounts of receivables for travel advances which have not been reported back to the STCU in a timely manner. (See Observation No. 3).
4. It was noted during the course of our audit that for a number of partner projects expenses incurred on the project are in excess of the partners cash contribution to date, exposing the STCU to the risk of bad debts. (See Observation No. 4).

You will appreciate that the inherent limitations in any accounting and internal control system mean that errors or irregularities may nevertheless occur and not be detected. Also, the projection of any evaluation of the systems to future periods is subject to the risk that management information and control procedures may become inadequate because of changes in conditions or that the degree of compliance with those procedures may deteriorate.

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

**TABLE OF CONTENTS**

		<b>Page</b>
<b>I</b>	<b>AUDIT FINDINGS SUMMARY</b>	<b>1</b>
<b>II</b>	<b>AUDITOR'S REVIEW</b>	<b>3</b>
	Observation 1    Contracts not dated	4
	Observation 2    Financial and technical monitoring of projects	6
	Observation 3    Travel grants	9
	Observation 4    Partner project expenses incurred in excess of cash contributions	12

## **I. AUDIT FINDINGS SUMMARY**

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.

**AUDIT FINDINGS SUMMARY**

<b>Item No.</b>	<b>Title</b>	<b>STCU Comments (Agreed or Not Agreed)</b>
1.	Contracts not dated.	<b>Partially Agree</b>
2.	Financial and technical monitoring of projects	<b>Agree</b>
3.	Travel grants	<b>Partially Agree</b>
4.	Partner project expenses incurred in excess of cash contributions	<b>Partially Agree</b>

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.

## **II. AUDITOR'S REVIEW**

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.

**Audit of the Science and Technology Center in Ukraine**  
**For the Year Ended 31 December 2009**  
**Management Letter**

---

**Observation No. 1**

- Title:** Contracts not dated.
- Description:** In the management letters for the years ended 31 December 1999 to 2008 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 many 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 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, although the STCU agrees that the dating of signatures is a very good practice, it will not return undated contracts to 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.
- Finally, the STCU would like to inform the readers of this management letter that significant strides have been made in addressing this issue.

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.



**Audit of the Science and Technology Center in Ukraine**  
**For the Year Ended 31 December 2009**  
**Management Letter**

---

**Observation No. 1**

For example, at the most recent STCU Governing Board (GBM 29), fifty-five (55) projects and extensions were approved for funding. Of those 55 projects, all but five (5) of those projects were signed and commenced by the date of publication of this management letter. Of the remaining fifty (50) projects that were signed and commenced, all but fourteen (14) of those fifty (50) projects had dated signatures for all parties (this according to the STCU's own investigation). Of the fourteen (14) projects missing signatures, twelve (12) of the projects were partner projects that require the signature of not just the STCU Executive Director and recipient institutes, but also the signature of Western partners. In a number of these cases, the signatures that were missing dates were those of Western partners. .

In sum, the STCU would like to emphasize that progress has been made on this issue, and that the problems are not always arising because of actions of STCU or of those parties located in the STCU recipient countries (i.e., recipient institutes).

**Audit of the Science and Technology Center in Ukraine  
For the Year Ended 31 December 2009  
Management Letter**

---

**Observation No. 2**

Title: Financial and technical monitoring of projects

Description: At the request of the U.S. Department of State, the STCU completed 6 U.S. sponsored technical and financial project audits in FY2009. The STCU worked closely with the U.S. D.O.S., Defence Contract Audit Agency (USDCAA), 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 Project P326 and 3984 it was noted that the certain project participants were related. The STCU was unaware of these relationships and they had not been notified to the STCU in accordance with Standard Operating Procedure VI, Project Financing.

We note that only one of the related project participants was subsequently assessed to be under qualified for her role and that she has been removed from the project.

We also noted that the senior specialist on project 3984 was unaware that all relationships between project participants need to be disclosed in writing with the project proposal.

- (b) It was noted for Project 3984 that six participants had worked in excess of 220 days in a year without gaining approval from the STCU, in breach of Standard Operating Procedure 24.
- (c) In relation to project P316 the project manager timesheet had not been approved by two other project participants as required by Standard Operating Procedure VII, Participation and Recording Hours Worked on STCU Projects.
- (d) In relation to project P316 one project participant did not personally complete the monthly and quarterly totals on her timesheet.
- (e) In respect of projects P316 and 3984 certain project institutes had not labelled equipment purchased under the project in accordance with Standard Operating Procedure XXII, Identification of Equipment Purchased for STCU projects.

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

- (a) With regard to related project participants we recommend that the STCU reminds all senior specialists of the need for relationships between project participants to be disclosed in writing with the project proposal.

We note that STCU monitoring visits for project P326 and 3894 were

**Audit of the Science and Technology Center in Ukraine**  
**For the Year Ended 31 December 2009**  
**Management Letter**

---

**Observation No. 2**

delayed due to the force majeure in 2008.

- (b) With regard to the 220 day rules being breached, it is recommended that the 220 day report is run on a monthly basis. Where there is evidence that a participant has breached the limit, or is close to the limit (210 days for instance) the participant in question should be informed on a timely basis to gain authorisation if 220 days are to be breached. Where a grantee continues to work above the 220 limit without authorisation, grants in excess of the 220 days should be withheld until authorisation is gained. It has been noted that the revised procedures introduced from October 2009 address some of the issues above.
- (c) With regard to non approval of the project managers time, we recommend that the STCU stress the terms contained in the Grant Letters to the project manager, that clearly state that time cards are to be approved by two other project participants, when the grant letter is signed.
- (d) With regards to the time cards not being completed personally by the project participant we recommend the STCU stress the terms contained in the Grant Letters to the participants, that clearly state that time cards are to be completed by personally by the participant, when the grant letter is signed.
- (e) With regards to the labelling of equipment purchased for STCU projects we recommend the STCU stress to project managers the need for equipment to be labelled in accordance with STCU policies and procedures at the time equipment is purchased.

STCU Comment: The STCU concurs with Lubbock Fine's recommendations and will continue to perform the following steps related to these issues:

- a) The STCU agrees with this recommendation and will continue to work with the Senior Specialists to remind them of the need for relationships between project participants to be disclosed in writing at the time of submission of the project proposal.
- b) The STCU will review 220 day requirements on a monthly basis and work with grantees to ensure that they acquire permission to work more than 220 days when necessary. In the cases where grantees work more than 220 days without authorization, the STCU will consider withholding the grant amount in excess of 220 days until authorization is finally received.
- c) The STCU agrees with this recommendation and will continue to stress to project managers the terms contained in the Standard Operating Procedure VII, which clearly state that timecards for project

**Audit of the Science and Technology Center in Ukraine  
For the Year Ended 31 December 2009  
Management Letter**

---

**Observation No. 2**

managers are to be approved by two other project participants.

- d) The STCU agrees with this recommendation and will continue to stress to project participants the terms contained in the grant letter, which clearly state that timecards are to be filled in personally by the grantee.
- e) The STCU agrees with this recommendation and will continue to stress to project managers the terms contained in the Standard Operating Procedure XXII that clearly state that equipment purchased by the STCU are to be labelled accordingly.

**Audit of the Science and Technology Center in Ukraine  
For the Year Ended 31 December 2009  
Management Letter**

---

**Observation No. 3**

Title: Travel grants

Description: In the management letter for the years ended 31 December 2007 and 2008, we noted a number of weaknesses in the travel grants system. During the course of our audit work for the year ended 31 December 2009 some of these weaknesses were still apparent, however it is noted that the STCU has made significant improvements in this area.

Currently the system within the STCU is to advance travel grants to Scientists for subsistence while abroad and other small travel expenses. Normally, large hotel and airfares are paid directly by the STCU.

The accounting at the point of advance is to debit Accounts Receivable (Project Grantee), credit Cash / Bank.

On receipt of the completed travel settlement voucher the STCU will debit Travel expense, credit Accounts Receivable (Project Grantee). Any amount owed back to the STCU will be recovered from the scientist and any amount due to the Scientist will be recorded as a payable (usually paid with the next grant payment).

For supplemental budget travel the system is the same but the receivable is recorded under Accounts Receivable from Non STCU/Non Project. It should be noted that this error is considerably smaller.

We have noted significant time delays between when travel has taken place and when travel is being reported back to the STCU. This leads to a number of issues:-

- a) For travel that has taken place within a financial year but has not been reported to the STCU before the year end, the expense of travel will be understated with a corresponding overstatement of Designated capital for projects;
- b) There exists a possibility that the amount advanced will prove to be irrecoverable;
- c) The Scientist could be out of pocket should they be owed money from the STCU;
- d) The STCU will not have accurate information in connection with remaining Designated Contributed Capital under supplemental budgets related to travel.

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.

Recommendation: In relation to the above we would make the following recommendations with regard to STCU Grantees:

- a) When an advance is made it must be communicated to the grantee that receipts and a completed travel settlement voucher are to be submitted to the STCU within a specified time period (to be in line with SOP 5, i.e. 7 days of travel).
- b) The date of intended travel should be noted on Navision so it will appear on the quarterly expense report which is included on the project file. This could then be used to calculate a rough provision of travel relating to the year.
- c) As part of the quarterly reports prepared by the project accountants, a review of travel advances should be made. For any travel receipts which have not been submitted within the specified time period, the grantee should be contacted directly.
- d) Continue implementing policies where grants are withheld from grantees, up to the value of the travel advance, if they repeatedly ignore requests to submit documents (120 days for instance).
- a) When the documents are received from the grantee any amounts due to/from the grantee should be settled in the next grant payment.

STCU Comment: The STCU partially concurs with Lubbock Fine's recommendations. As opposed to previous management letters where the STCU concurred with Lubbock Fine, the STCU now would like to only partially concur because of a different understanding of what is a "significant" amount of unsettled travel advances. The STCU agrees that the ideal goal would be to have no unsettled travel advances at the end of the fiscal year. However, given that a number of travellers will travel during December and the beginning months of the next year (January and February), it is very possible that advances will be made to these individuals that will not be settled in time for the closing of the financial statements.

As of December 31, 2009, the total amount of Accounts Receivable (Project Grantee) was \$135,082. Of that amount, \$7,750 was for travel that took place in December 2009 and \$16,560 was for travel that took place in January 2010. Thus, \$110,772 was for travel that occurred prior to November 30, 2009 (\$135,082 less the sum of the December and January travel). While this is unsettled travel amount is not zero, given that project expenses totaled \$15,902,171 in 2009, the STCU disagrees that the \$110,772 amount is "significant". For comparison sake, the readers of this management letter should be aware that this observation first arose in the 2007 management letter, when the figure for unsettled project travel in the December 31, 2007 financial statements was \$390,130. The STCU agreed that this amount was significant, and implemented the recommendations put forth by Lubbock Fine in that 2007 management letter, bringing the amount down to what exists today.

Furthermore, the reduction in Accounts Receivable from Non STCU/Non Project since 2007 has been even more significant. In 2007,

this receivable stood at \$165,369, versus \$25,200 in 2009. Of that \$25,200, \$21,063 was for travel that was to occur in 2010. In other words, only the difference of \$4,137 was for travel in 2009 that could have been shown as supplemental expense in the 2009 financial statements.

Finally, the STCU agrees to continue implementing the recommendations set forth by Lubbock Fine since the 2007 management letter in order to further reduce the amounts of unsettled travel.

**Audit of the Science and Technology Center in Ukraine**  
**For the Year Ended 31 December 2009**  
**Management Letter**

---

**Observation No. 4**

- Title:** Partner project expenses incurred in excess of cash contributions
- Description:** During the course of our audit we have noted that as at 31 December 2009, 17 projects had incurred project expenses in excess of the cash the STCU has received for that project from the relevant funding party.
- This means that the Accounts Receivable (A/R) from funding partners is in excess of Designated Capital Contributions – Projects (DCC - Projects) for each project which exposes the STCU to the risk of bad debts. This risk exists as the STCU is the contracting body with the project grantees and may therefore be obliged to make grant payments in excess of cash receipts from partners. It should be noted that this situation has yet to arise.
- The STCU currently has a procedure which stops payments being made for projects when DCC - Projects is equal or less than accounts receivable. However, this safeguard still allows expenses to be accrued for a project, which could potentially create an obligation for the STCU to settle these amounts, whether or not the cash is ever received from the funding partner.
- Recommendation:** In relation to the above we would make the following recommendations:
- a) As part of the quarter end procedures the amount of available funds remaining for the project should be noted by the project accountant on the project file (Being DCC - project less A/R).
  - b) This should be compared to the budgeted spend for the following quarter to ascertain if it is likely that the project will go into a 'negative' funding position in the next quarter.
  - c) Where a project does go into a negative funding position, the funding partner should be contacted immediately and informed of the situation. The project should be suspended if it appears the partner will delay in providing the STCU with the next cash payment to fund the project.
  - d) Where it is expected that project funding will become negative in the next quarter, the STCU should contact the partner and remind them of the expected due dates for project funding.
- STCU Comment:** The STCU partially concurs with Lubbock Fine's recommendations. As opposed to last year's management letter, where the STCU concurred with Lubbock Fine, the STCU now would like to only partially concur because of the following two reasons:

---

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. No responsibilities are accepted by Lubbock Fine towards any party acting or refraining from action as a result of this report.



**Audit of the Science and Technology Center in Ukraine**  
**For the Year Ended 31 December 2009**  
**Management Letter**

---

**Observation No. 4**

- a) *De Jure* – All STCU project agreements contain the following condition:

**Article 9.2 – The Center shall not be liable for non-performance by the Partner or the Recipient(s) of their obligations under the Agreement.**

- b) *De Facto* – As pointed out by Lubbock Fine above, there have been occasions where Partners have refused to make payments for work performed by institutes and grantees. In all cases, the STCU has not been obligated to step in and pay for these expenses; in the end, the grantee(s) and institute(s) suffered the loss. The STCU agrees with Lubbock Fine that because it has not happened in the past, does not mean that it cannot happen in the future. However, the STCU believes that the wording in the STCU project agreement is very clear on this matter (see point a. above).

The STCU would like to point out to the readers of this management letter that in order to work with certain partners (i.e. European Commission/CORDIS/7<sup>th</sup> Framework Programme, EOARD, etc.), the STCU has to accommodate payment systems which require work to be done by the scientific team in advance, which is then reviewed by the Funding Party, and then approved for payment. For example, of the seventeen (17) projects mentioned above, five (5) projects were financed via the 7<sup>th</sup> Framework Programme which follows this model.

Finally, the STCU agrees to continue implementing the recommendations set forth by Lubbock Fine listed above and in the 2008 management letter in order to further reduce the risks of non-payment by partners, as this is good business practice in any case. However, the STCU will continue the practice of allowing partners to accrue expenses in excess of cash received (but not pay cash out in excess of cash received), because as highlighted above, STCU requires some flexibility in order to accommodate the requirements of its many different partners.