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# The Science and Technology Center in Ukraine

Management Letter for the year  
ended  
31 December 2013



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**Private and confidential**

11 April 2014

Dear Mr. Curtis M. Bjelajac

We have audited the financial statements of the Science and Technology Center in Ukraine (hereinafter "STCU") as at and for the year ended 31 December 2013.

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

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

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

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

Yours sincerely,  
KPMG Baltics SIA

Armine Movsisjana  
Partner

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# 1 Value added tax on "Biosafety and biosecurity improvement at the Ukrainian Anti-Plague station (UAPS) in Simferopol" project expenditure

## Observation

In the year 2011 the SCTU has signed 5 project agreements #9800 to #9804, "Biosafety and biosecurity improvement at the Ukrainian Anti-Plague station (UAPS) in Simferopol". The project includes the following steps (1) Securing Existing Facility to Improve Biosecurity Level; (2) Conceptual Design of New Laboratory Facility, Work Estimate and New Site Investigation; (3) Executive Design of New Laboratory Facility, Licensing, Construction and Commissioning; (4) Equipment; (5) Set Up of Management Structure for the Operational Phase, New Facility Procedures Drafting and Staff Training.

The project is financed by the European Union and the total financing amounts to EUR 4 000 000. According to the "General and Administrative Provisions" of the project agreement taxes shall not be considered as eligible costs, unless the STCU is not able to reclaim them.

On December 20, 2012, the STCU sent a letter addressed to Mr. Eddie Maier of the European Commission explaining the VAT situation, and asked Mr. Maier for a VAT exemption for the above projects. No response has been received as at the date of this letter.

In 2013 the STCU received permission from the Ukrainian government to reclaim VAT on project #9805. However, no further actions have been taken in relation to above mentioned projects due to the deteriorated political situation in Ukraine.

## Implication

Although the amount of input valued added tax incurred on project expenditure to date is not significant, taking into account total estimated project expenditure and the fact that the Ukrainian government has provided a mechanism for the STCU to reclaim input value added tax, the European Union could treat input valued added tax incurred on project expenditure as not eligible cost and reduce the amount of final payment (5% of the total project expenses) and attempt to recover the amount incurred from the STCU.

## Recommendation

We recommend the management of the STCU to contact the state tax authorities again as soon as political tension is resolved. Alternatively, we recommend that the STCU reconsiders the treatment of input value added tax as non - eligible project expense.

## Management response

Agree

Upon the resolution of the political tension in Ukraine, and a new government is identified after the scheduled May 25, 2014 Ukrainian Presidential elections, the STCU will once again revisit the issue of receiving a VAT exemption letter from the Ministry of Health of Ukraine in order to make VAT-exempt purchases for projects 9800 – 9804.

## 2 Contribution in kind of office premises

### Observation

From March 2009, the STCU have occupied office premises provided by the Ukrainian government for which the STCU does not pay rental or utility charges. In 2013 the management hired independent real estate valuers to estimate the fair value of the rental and utility benefit provided by the Ukrainian government in the reporting year and disclosed the amounts in the IFRS financial statements. No comparative information was provided for the year ended 31 December 2012. As there is no comparative data available the STCU did not recognise the fair value of rent and utility expenditure as capital contribution to Administrative Budget transferred to Statement of Revenue and Expenditure.

### Implication

The contribution in kind by the Ukrainian government, being one of the Funding Parties, is not reflected in the STCU financial statements' capital accounts. In accordance with International Financial Reporting Standards, any contribution in kind received from Funding Parties should be measured at fair value and reflected as capital contribution to Administrative Budget transferred to Statement of Revenue and Expenditure. Offsetting accounting entry to recognize the fair value of rent and utility expenditure should be recognized.

### Recommendation

Upon obtaining a comparative data, we recommend to reflect the rental and utility charge contributed by Ukraine as the Funding Party in the Designated Capital Contributions – Administration and the rental and utility expenses incurred in Administrative Expenditure. This will disclose the substance of the transaction to the readers of the financial statements.

### Management response

Agree

In 2014 the STCU will again hire independent real estate valuers to estimate the fair value of rental and utility benefit provided by the Ukrainian government in 2014 and reflect this and the 2013 information in the Designated Contributed Capital Contributions – Administration and in the Administrative Expenditure sections of the December 31, 2014 financial statements.



## 3 Procurement procedure

### Observation

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

During the audit we noticed that several Institutes namely P496, P457, P460, P506 have done purchases from the same supplier and on the same date or the next day where expenses of individual purchase invoices are below 2 500 USD, but by aggregating these purchase invoices expense amount would exceed 2 500 USD. We are not aware if price comparison was performed in these procurement processes; however, we have verified that no Partner approval.

### Implication

While the instances noted above do not seem to contradict the STCU procurement policies (expenditure did not relate to property, plant and equipment and was below individual threshold of 2 500 USD), we see potential risk of intentional misinterpretation of the policies by exercising their form over substance. The current procurement policy allows Institutes to avoid the standard STCU procurement procedure and specific rules of obtaining a written confirmation from the Partner by simultaneously purchasing multiple items below 2 500 USD and treating them as materials and not equipment.

### Recommendation

We recommend to the management of the STCU to revise the standard procurement policy and the special conditions related to the procurement procedure. We advise to specify in the standard STCU procurement procedure to which type of expenditure (only property, plant and equipment vs materials and services) there is a necessity of written price quotation. Identification of expense type should also be added to the special conditions paragraph, and the fact that a limit of 2 500 USD applies to individual items, rather than to the overall purchase invoice. We also recommend setting a gross threshold, for example, 5 000 USD per month, for purchases from the same vendor regardless the expenditure type that would further need to be analysed for price reasonableness and require approvals.

### Management response

Agree

The STCU will work with the Governing Board to revise the STCU financial regulations to incorporate the recommendations above from KPMG, as well as to synchronize our financial regulations with the ISTC.

## Contact us

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