

Azerbaijan Micro-Finance Association

**Management Letter on Internal Control and
Accounting Issues**

For the year ended 31 December 2008

Mrs. Jhale Hajiyeva
Executive Director
Azerbaijan Micro-Finance Association
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Jafar Jabbarli street 44
Baku Azerbaijan

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MANAGEMENT LETTER ON INTERNAL CONTROL AND ACCOUNTING ISSUES

Dear Mrs. Hajiyeva,

We are pleased to present our Management Letter (“the Report”) in connection with the audit of the financial statements of Azerbaijan Micro-Finance Association (the “Association”) for the year ended 31 December 2008.

The main purpose of this Report is to highlight recommendations on internal control issues identified during the course of an audit of the financial statements for the current year and prior periods. Our study and evaluation of internal controls were made for the purpose of determining the extent of the audit procedures necessary to express an opinion on the financial statements of the Association for the year ended 31 December 2008. The recommendations in the attached Report therefore do not include all possible recommendations that a special study and evaluation made to report on the system of internal control as a whole might disclose, but only those important areas of potential improvement which came to our attention during our examination of the financial statements. We have not performed any audit procedures that could have detected other weaknesses since the completion of our audit field work in January - February 2009. We believe the recommendations in this Report will be useful to you in improving your internal control environment and in detecting errors or weaknesses.

This Report is intended solely for the information and use of the management and board members of the Association, and should not be released to any third party without our prior written consent. We will not accept any liability in case this report is released to third parties.

We would also like to take this opportunity to thank the Association’s management and those employees of the Association who helped us during the course of our audit.

We would be pleased to provide you with any assistance necessary to implement our recommendations.

Yours sincerely,

Tural Maharramov

Audit Partner

Introduction

The purpose of this report is to provide observations regarding the Association's system of internal and accounting control identified during our normal audit procedures. In general, the main elements of an internal control structure are the control environment, risk assessment, control activities, monitoring of controls, information and communication, together with accounting system, compliance with laws and regulations, and policies and procedures.

Control Environment

The control environment is a reflection of management's attitude, awareness and actions, and represents the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures. It includes such factors as:

- management's philosophy and operating style;
- the organizational structure;
- the functioning of the executive committees;
- methods of assigning authority and responsibility;
- management's control methods on activities.

The applicability and importance of the above factors are affected by the entity's size and its organization.

Accounting System

A well-designed accounting system that is operating effectively can provide reliable accounting data and detect and prevent misstatements that otherwise could occur.

Compliance with laws and regulations

This element of the internal control structure assumes proper execution of the Association operations under the framework of the legislation of the Azerbaijan Republic affecting the financial results of the Association. In particular, this area covers legislation on labor, customs legislation and policies and procedures for cash and bank operations, as well as compliance of the Association operations with provisions of the Charter.

Policies and Procedures

This component of any internal control structure is determined by, and to some extent has an impact on, the effectiveness of the other components. Control procedures pertain to:

- proper authorization of transactions and activities;
- segregation of duties to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or irregularities in the normal course of his or her duties;
- design and use of adequate documents and records to help ensure proper recording of transactions and events;
- adequate safeguards over access to and use of assets and records;
- independent check on performance of operations;

With respect to the above factors, we did not note any significant internal control weaknesses that would require immediate action by management. However, we identified certain opportunities for improving the system of internal controls.

The following recommendations relate to issues identified during our audit of the financial statements of the Association for the year ended 31 December 2008.

Summary of control recommendations

	Issues identified during the audit	Management comments / Status
1	Approved annual budget and comparison with the actual figures	Agreed
2	Lack of procurement procedures	Agreed
3	Official approval of board resolutions	Agreed
4	Lack of proper documentation	Agreed
5	Lack of fixed assets register	Agreed
6	Unresolved tax issues	Agreed

RECOMMENDATIONS RESULTING FROM THE AUDIT

1. APPROVED ANNUAL BUDGET AND THE COMPARISON WITH THE ACTUAL FIGURES

Observation - During our audit, we noted that the Association does not get the official approval of the annual budget from the board of directors and the analysis of the difference between the approved budget and actual figures is not submitted to and approved by the board appropriately.

Implication - Lack of the official approval of the budget may lead the poor reliance over the budget items that are seen in line with the actual figures at the end of the period. Discontinuous comparison and control of the expenses with the approved budget, poor analysis of discrepancies and not getting the approval of them may have a serious impact on application of the budget.

Recommendation - We recommend the management properly gets the official approval for the annual budget and supervise and monitor the performance of Association by following up all expenses and payments by comparing with the detailed approved budget when the expenses and payments incurred. Moreover, the Association is recommended to prepare yearly discrepancies analysis report for the over-budget and under-budget items as per the comparative budget and actual expenses report and get the approval of the board for this report.

Management's response - We agree with your comment and will make all efforts to improve this issue.

2. LACK OF PROCUREMENT PROCEDURES

Observation - During the audit we observed that the Association does not apply competitive bidding procurement procedures when realizing the purchase of some materials and services and there is no any approved procurement procedure that clarifies the ways and steps of procurements.

Implication – Single source of procurement of goods and services or lack of the application of competitive bidding procedures may lead the management of the Association not to properly analyze the market price level and purchase the goods and services over the market level.

Recommendation - We recommend that the management prepares and gets the approval from the board for the procurement procedures that explain the ways and the steps of incurring the expenses. Afterwards, the management is recommended to ensure the proper application of the procurement procedures.

Management's response – We agree with your comment and will make all efforts to improve this issue.

3. OFFICIAL APPROVAL OF BOARD RESOLUTIONS

Observation - During the audit we observed that the Association does not get the signatures of all board members on the board resolutions. Board resolutions are prepared, signed and sealed by the management of the Association.

Implication – From time to time, there may be some conflicts between the one or more board members and the management related to the execution or non-performance of the resolved matters. Without approval by the signatures of the all board members, the management could not be make sure that all resolutions are approved with clear understanding.

Recommendation - We recommend that the management gets the approval of the board for the all board resolutions with the signatures of all members.

Management's response – We agree with your comment and will make all efforts to improve this issue.

4. LACK OF PROPER DOCUMENTATION

Observation - During the audit we observed that there is no any system for the issuing of the invoices to the customers. Such as, there may be more than one invoice for single service with different data, but no any indication of which is valid and or final.

In addition, we observed that, certain payments to the customers are realized without obtaining full set of supporting documents such as contracts, invoices i.e.

Moreover, poor documentation of bonus payments to the employees is also observed during the course of our audit.

Implication – The poor documentation may lead to the weak internal control system.

Recommendation - We recommend that the management prepares and gets the approval of accounting guidance which includes steps and procedures to check the quality of documentation.

Management's response – We agree with your comment and will make all efforts to improve this issue.

5. LACK OF FIXED ASSETS REGISTER

Observation – During our audit it was noted that the Association does not have a proper system to track fixed assets and calculate depreciation. The Association uses neither a special program nor a excel spreadsheet to track all of its fixed assets and to calculate depreciation expense.

Implications – Tracking fixed assets from hard copy documents or accounting program is limited with respect to asset tracking, tax information, and data security, and has a higher risk of error.

Recommendation – The Association should create a fixed asset register to track all existing assets, additions, disposals, and transfers, and automatically calculate depreciation expense.

Management's response – We agree with your comment and will make all efforts to improve this issue.

6. UNRESOLVED TAX ISSUES

Observation – During our audit it was noted that the Association has some non-clarified tax issues that needed to be resolved with the Ministry of Taxes. Despite the management of the Association believes that revenues from international training and conferences related to the development of microfinance sector are exempt from profit tax, tax legislation doesn't specifically indicate so.

Implications – The Azerbaijani tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that revenues that have not been taxed in the past may be taxed.

Recommendation – The Association should invite experienced tax consultant(s) to analyze the issues and appropriately manage the results of tax consultation (to reflect the tax balances with the Tax Ministry in accounting records and financial statements or obtain official letter on matter from the Ministry of Taxes, releasing the Association from any tax payments).

Management's response – We agree with your comment and will make all efforts to improve this issue.