Microfinance Working Group for the Lao PDR

(Funded by the United Nations Capital Development Fund, Appui au Développement Autonome-Luxembourg, German International Cooperation-Access to Finance for the Poor Project, Saving Banks Foundation for International Cooperation, Small Enterprise Education and Promotion Network, Banking with the Poor Network, Deutscher Genossenschafts-und Raiffeisenverband e. v and other donors)

Management Letter

31 December 2012
PRIVATE & CONFIDENTIAL

Mr. Bandith Sisoukda
Chair
Microfinance Working Group for the Lao PDR
Vientiane Capital;
Lao PDR

15 March 2013

Management Letter for the year ended 31 December 2012

Dear Mr. Bandith

We have now completed our audit of the financial statements of the Microfinance Working Group for the Lao PRD ("the MFWG") funded by the various donors namely United Nations Capital Development Fund ("UNCDF"), Appui au Développement Autonome-Luxembourg ("ADA-Luxembourg"), Saving Banks Foundation for International Cooperation ("SBFIC") and German International Cooperation-Access to Finance for the Poor Project ("GIZ-AFP"), Small Enterprise Education and Promotion Network ("SEEP"), Banking with the Poor Network ("BWTP"), Deutscher Genossenschafts-und Raiffeisenverband e. v ("DGRV") and other donors as at and for the year ended 31 December 2012. During the course of the engagement, we have reviewed the MFWG's accounting system and internal controls over its activities and, in accordance with our normal practice; we wish to highlight certain matters that came to our attention.

Our review of the accounting systems and internal controls was conducted to assist us in expressing an opinion on the financial statements of the MFWG as at and for the year ended 31 December 2012. Our work was not primarily directed towards the discovery of weaknesses, or detection of fraud, or other irregularities, other than those which would influence us in forming our opinion, and should not therefore be relied upon to show that no other weaknesses exist. Accordingly, the comments that follow refer only to those matters which have come to our attention during the course of our normal audit work and do not attempt to indicate all possible improvements had a special review been performed.

We enclose a memorandum of the points we have noted during our audit together with our recommendations and the MFWG Management's comments. We also followed-up on prior year's recommendation and included the status of each recommendation in the attached memorandum.

In order to assist the MFWG Management in efficiently addressing the points we have noted and improve the MFWG's current system of internal controls, we have classified our findings and recommendations under the following categories:

- **High Priority:** This is very critical to the MFWG's operation and strategy in the short-term hence, requiring immediate actions within 12 months or, this will have very significant financial consequence.

- **Medium Priority:** This is essential for the MFWG's operation and strategy in the next 2-3 years or somewhat having significant financial impact.

- **Low Priority:** This is important for the MFWG to consider for its operation and strategy in the long-term which, nevertheless, require improvement. It has no immediate or significant financial impact.
We summarise below the areas highlighted in our Management Letter.

<table>
<thead>
<tr>
<th>No.</th>
<th>Recommendations</th>
<th>Level of priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The MFWG's hand book should be maintained, formalized, and made available to all staff in the form of an operation manual. The MFWG should combine the information in a hand book including an organizational chart, description of staff positions, duties and responsibilities, detailed description of accounts, methods, procedures and accounting principles, detailed description and frequency of report to be prepared, chart of account, description of accountable documents or forms, description of internal control procedure and procurements guideline which are separately documented.</td>
<td>High</td>
</tr>
</tbody>
</table>
| 2   | • The MFWG Management should perform a full physical verification of fixed asset at least once a year by a person independent to the custody of the assets. The result of count should then be reconciled with the items listed in the fixed asset register. And any differences ie. Lost or unaccounted asset should be investigated and resolved on a timely basis. The result of the fixed assets count should be reviewed and approved by a designated the MFWG Management.  
• All fixed assets of the MFWG should be tagged with an authorised registration number or a particular sign in order to strengthen control over the physical existence of assets. And on the other hand, Identification numbers should be assigned and affixed to each asset in order to facilitate easy identification of the MFWG’s assets during physical verification and cross references should be made to the fixed asset register to facilitate checking these assets against the register;                                                                 | Medium            |
| 3   | We recommend that the MFWG should make clear and request for the tax exemption letter with the tax authorities and Ministry of Finance when its registration licence is issued.                                                                                                                                                                                                                   | Medium            |
|     | In the case of the tax authority and Ministry of Finance did not allow for tax exemption, the personnel income tax ("PIT") of the MFWG’s employee should be calculated on gross income including all allowances and other benefits, which are deemed assessable income. PIT should be deducted monthly and remitted to the tax authorities not letter than 15th day following the end of the month.  
All expenditures on personnel income tax should be supported by original tax authorities invoice.                                                                                                                                                                                                                                                                             |                   |
| 4   | We recommend that roles and responsibilities between cashier and accountant functions be handled by different individuals to strengthen control over cash and bank transactions in the MFWG.                                                                                                                                                                                                  | Medium            |
| 5   | All payment vouchers and supporting documents should be immediately stamped "PAID" once payment is processed. The same should be done on bills and invoices once presented for reimbursement or as supporting document to an advance that is being liquidated.                                                                                                                                                                                                                   | Medium            |
We shall be pleased to be kept informed of future developments/changes in the internal control procedures and, in the meantime, please do not hesitate to contact us if you require further explanations or information.

We take this opportunity to place on record our appreciation for the assistance and co-operation extended to us by the MFWG Management and its staff during our recent audit.

Yours faithfully

Ounheuane Amkhavanh
Managing Director

Vientiane Capital

15 March 2013
Microfinance Working Group for the Lao PDR

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Management Letter
31 December 2012

1 MFWG Management should establish and implement an operation manual and a financial guideline.

Observation and Implication

We understand that the MFWG has maintained an organizational chart, detailed description of positions, duties and responsibilities of staff, detailed description of accounts methods, procedures and accounting principles, detailed description and frequency of report to be prepared, described a chart of accounts and described accountable documents or forms to be used and its internal control procedure and procurement guideline. However, the MFWG did not combine the information in a hand book for its accounting team and currently operates without the benefit of a formal operation manual.

The absence of formal operation manual or hand book and procedures increases the risk that the responsibility over specific tasks and functions is not fixed, transactions are not properly, timely and consistently accounted for, reviewed, approved and reported. Consequently, the financial statements may not reflect a true and fair view of the MFWG’s financial position and receipts and disbursements.

Recommendation

The MFWG’s hand book should be maintained, formalized, and made available to all staff in the form of an operation manual. The MFWG should combine the information in a hand book including an organizational chart, description of staff positions, duties and responsibilities, detailed description of accounts, methods, procedures and accounting principles, detailed description and frequency of report to be prepared, chart of account, description of accountable documents or forms, description of internal control procedure and procurements guideline which are separately documented.

MFWG Management’s response

MFWG Management fully agrees with this recommendation. It has already included the development of an Operations Manual outlining all relevant organizational policies and regulations in its work plan for 2013. This manual will be designed in the course of 2013, subject to the availability of additional staff.
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Management Letter (continued)
31 December 2012

2. Control and monitoring over fixed assets should be enhanced.

Observation and Implication

We noted the following deficiencies with respect to control over control and monitoring over fixed assets:

- The MFWG did not perform physical verification of fixed assets during the year or at the year ended. Loss or damage over fixed assets may not be detected on timely basis, if the MFWG did not perform physical verification of fixed assets.
- We understand that all the fixed assets purchasing by each donor funds would be kept tracking in the fixed assets registration ("FAR") which are prepared by donors. However, it’s noted that the MFWG’s fixed assets funded by ADA and SBFIC were not tagged as the MFWG has tagged the fixed assets code just only for the fixed assets funded by GIZ. In the absence of such tags it is difficult to identify the MFWG’s assets during physical inspections and exercise proper control over the existence of those assets. There is also a high risk of misappropriation of the assets.

Recommendation

- The MFWG Management should perform a full physical verification of fixed assets at least once a year by a person independent to the custody of the assets. The result of count should then be reconciled with the items listed in the fixed asset register. And any differences ie. Lost or unaccounted assets should be investigated and resolved on a timely basis. The result of the fixed assets count should be reviewed and approved by a designated representative of the MFWG Management.
- All fixed assets of the MFWG should be tagged with an authorised registration number or a particular sign in order to strengthen control over the physical existence of assets. And on the other hand, Identification numbers should be assigned and affixed to each asset in order to facilitate easy identification of the MFWG’s assets during physical verification and cross references should be made to the fixed asset register to facilitate checking these assets against the register;

MFWG Management's response

MFWG Management will ensure that a full physical verification of fixed assets will be performed at the end of the year, provided that the MFWG disposes of the required staff (accountant) to perform this task. It will also make sure that the result of the asset verification will be reviewed and approved by the relevant superior.

MFWG Management will also ensure that the fixed assets which have not yet been tagged will be tagged and registered before the end of 2013.
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Management Letter (continued)
31 December 2012

3 Ensure compliance with prevailing Tax Law to avoid possible penalties

Observation and Implication

We understand that the MFWG is in the process of requesting official registration as an association in the Lao PDR. Therefore, during the year, the MFWG did not calculate, withhold, declare and remit personnel income tax ("PIT") to the tax authorities in accordance to the Article No 45,46,47,48,49,50 of the Tax Law of Lao PDR (revised version date 20 December 2011). However, in the future, we would like to draw attention to the matter that no calculation, withholding, declaration and remittance of the personnel income tax to the tax authority may result in penalties being levied to both the MFWG and its employee should the Revenue Department perform an inspection of the MFWG’s books and records.

Recommendation

We recommend that the MFWG should make clear and request for the tax exemption letter with the tax authorities and Ministry of Finance when its registration licence is issued.

In the case of the tax authority and Ministry of Finance did not allow for tax exemption, the personnel income tax ("PIT") of the MFWG’s employee should be calculated on gross income including allowances and other benefits, which are deemed assessable income. PIT should be deducted monthly and remitted to the tax authorities not letter than 15th day following the end of the month.

All expenditures on personnel income tax should be supported by original tax authorities invoice.

MFWG Management’s response

The MFWG will ensure that this is addressed as soon as the MFWG has received its association license.
4. Segregation of duties between cashier and accountant should be done

Observation and Implication

We understand that the MFWG Management is in the process of recruiting an accountant and a national director. However, it’s noted that during the year, the accountant also performed the functions of the cashier in the MFWG. The segregation of duties is an important aspect within the accounting system. Lack of segregation of duties may create opportunity for the misappropriation of the MFWG’s funds.

Recommendation

We recommend that roles and responsibilities between cashier and accountant functions be handled by different individuals to strengthen control over cash and bank transactions in the MFWG.

MFWG Management’s response

MFWG Management acknowledges that in the past the function of cashier and accountant could not be segregated due to a lack of staff. However, it will ensure that these two functions are separated as soon as it has been able to fill the accountant position.
5. Control over cash disbursement should be improved

Observation and Implication

We noted that some receipts that have already processed for payment were not stamp "PAID". No stamp "PAID", the receipt might be presented again for payment or used again for liquidate an advance. See details in Appendix I.

Recommendation

All payment vouchers and supporting documents should be immediately stamped "PAID" once payment is processed. The same should be done on bills and invoices once presented for reimbursement or as supporting document to an advance that is being liquidated.

MFWG Management's response

MFWG Management engages to eliminate these shortcomings.
<table>
<thead>
<tr>
<th>Areas of comments</th>
<th>Year</th>
<th>Recommendation</th>
<th>Implementation status in the year</th>
<th>Project Management's response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 MFWG Management should establish and maintain an accounting manual and a financial guideline.</td>
<td>2011</td>
<td>The MFWG's hand book should be maintained, formalized, and made available to all staff in the form of a manual. The MFWG should combine the organizational chart, description of staff positions, responsibilities, duties and roles to be prepared, chart of account, description of principles, methods, procedures and accounting documents, forms, and procedures of accountable document forms, description of internal control procedure and procedures.</td>
<td>Not implemented</td>
<td>Refer to current year point No. 1</td>
</tr>
<tr>
<td>2. The MFWG Management should enhance controls over cash on hand and at bank.</td>
<td>2011</td>
<td>The MFWG Management should ensure proper control of expenditure. Payments exceeding this limit should be made by cheque to ensure more</td>
<td>Implemented</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

Management Letter (continued)
### 6. Follow up the previous year’s management letter points (continued)

<table>
<thead>
<tr>
<th>Areas of comments</th>
<th>Year</th>
<th>Recommendation</th>
<th>Implementation status in the year</th>
<th>Project Management’s response</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Ensure compliance with prevailing Tax Law to avoid possible penalties.</td>
<td>2011</td>
<td>- We recommend that the MFWG should make clear and request for the tax exemption letter with the tax authorities and Ministry of Finance when its registration licence is issued.</td>
<td>Not yet implemented. Refer to the current year point No 3</td>
<td>Refer to the current year point No 3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- In the case of the tax authority and Ministry of Finance did not allow for tax exemption, the personnel income tax (&quot;PIT&quot;) of the MFWG's employee should be calculated on gross income including allowances and other benefits, which are deemed assessable income. PIT should be deducted monthly and remitted to the tax authorities not letter than 15th day following the end of the month.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- All expenditures on personnel income tax should be supported by original tax authorities invoice.</td>
<td></td>
<td></td>
</tr>
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Management Letter (continued)
31 December 2012

6. Follow up the previous year's management letter points (continued)

<table>
<thead>
<tr>
<th>Areas of comments</th>
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<th>Recommendation</th>
<th>Implementation status in the year</th>
<th>Project Management's response</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Segregation of duties between cashier and accountant should be done.</td>
<td>2011</td>
<td>We recommend that roles and responsibilities between cashier and accountant functions be handled by different individuals to strengthen control over cash and bank transactions in the MFWG.</td>
<td>Not yet implemented. Refer to the current year point No 4</td>
<td>Refer to the current year point No 4</td>
</tr>
</tbody>
</table>
Appendix I: No stamp “PAID” on the receipt.

<table>
<thead>
<tr>
<th>Date</th>
<th>Reference</th>
<th>Description</th>
<th>Amount in LAK</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>27/02/2012</td>
<td>15</td>
<td>MFWG brochure printed</td>
<td>90,000</td>
<td>No stamp paid on the receipt</td>
</tr>
<tr>
<td>27/02/2012</td>
<td>18</td>
<td>Transportation allowance for MFWG BOD (Somchith B)</td>
<td>100,000</td>
<td>No stamp paid on the receipt</td>
</tr>
<tr>
<td>06/04/2012</td>
<td>4</td>
<td>Lao New Year Cards for BOD and BOL</td>
<td>100,000</td>
<td>No stamp paid on the receipt</td>
</tr>
<tr>
<td>30/04/2012</td>
<td>31</td>
<td>MRPD Banner</td>
<td>180,000</td>
<td>No stamp paid on the receipt</td>
</tr>
<tr>
<td>22/6/2012</td>
<td>12</td>
<td>Snacks for MFWG Member Meeting</td>
<td>160,000</td>
<td>No stamp paid on the receipt</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>630,000</strong></td>
<td></td>
</tr>
</tbody>
</table>