

MUNICIPAL DEVELOPMENT AND LENDING FUND

MEMORANDUM OF SUGGESTIONS
FOR IMPROVEMENT OF THE INTERNAL CONTROL AND
ACCOUNTING SYSTEM
DECEMBER 31, 2015

El Wafa Company

For Financial Consulting & Accounting Services

Correspondents of the International firm
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March 31, 2016

To: The Board of Directors
Municipal Development and Lending Fund (MDLF)
Ramallah

Dear Sirs,

We have audited, in accordance with International Standards on Auditing, the financial statements of the Municipal Development and Lending Fund (MDLF) as at December 31, 2015 and for the year then ended and issued our independent auditors' report thereon dated March 31, 2016.

Under International Standards on Auditing, auditors are **encouraged** to report various matters concerning an entity's internal control structure noted during an audit, and are **required** to report certain of those matters. Matters that are required to be reported are "significant deficiencies in the design or operation of the internal control structure that, in the auditor's judgment, could adversely affect the organization's ability to record, process summarize and report financial data consistent with the assertions of management in the financial statements."

As part of our audit, we considered the internal control structure in determining the scope of our audit procedures for the purpose of rendering an opinion on MDLF's financial statements. While our purpose was not to provide assurance on the internal control structure, certain matters "which are not required to be reported as defined in the preceding paragraph" came to our attention that we want to report to you. These matters, along with our recommendations, are described in the accompanying memorandum.

This letter and memorandum are intended solely for the use of management and are not intended for any other purposes.

We wish to express our appreciation for the courtesies and cooperation extended to our representatives during the course of their work. We would be pleased to discuss our recommendations in greater detail with you.

Sincerely yours,
El Wafa Company



Musa Abu Dieh

TABLE OF CONTENTS

FOLLOW-UP ON PRIOR YEAR MANAGEMENT LETTER	1
1. Financial Policies and Procedures Manual	1
2. Fixed Assets Module.....	3
3. Internal Audit Function	4
4. End of Service Benefits	5

FOLLOW-UP ON PRIOR YEAR MANAGEMENT LETTER

1. Financial Policies and Procedures Manual

Observation

We noted the following regarding MDLF's Financial Policies and Procedures Manual (the Manual):

- According to the Manual the authorized signatories are:
 1. Director General (signature A),
 2. General Director of Operation (signature B),
 3. Financial and Administration Manager (signature B).

However, we noticed that the actual authorized signatories are:

1. Chairman of BoD (signature A),
 2. Director General (signature B),
 3. Financial and Administration Manager (signature B).
- According to the Manual, a pre-numbered Internal Purchase Requisition (IPR) should be used for each request of goods and services that exceeds USD 10. However, we noticed that the used IPR is not pre-numbered, instead it is manually numbered.
 - According to the Manual, a list of approved vendors should be prepared and maintained for tenders updated annually. However, we noticed that this procedure is not implemented.

Recommendation

We recommend MDLF to implement its Financial Policies and Procedures Manual and update it as and when needed.

Management Comments

- The current authorized signatories are based on BoD decision. The BoD explains that they will authorize the executive management after approving the BoD manual, MDLF law and having an effective internal audit function at MDLF.
- MDLF is using Internal Purchase Requisition (IPR). The IPRs are manually numbered after having the official approvals. MDLF is monitoring the IPRs by recording them on an excel sheet with their numbers. MDLF believes that the current procedures are sufficient for monitoring and controlling the IPRs.
- MDLF purchases the needed equipment or supplies by requesting quotations from at least 3 suppliers or vendors.

Current Year's Status

No actions were taken by MDLF in respect to this observation.

Management Comments on Current Year's Status

MDLF still believe that the above mentioned reply to the external auditor's comment still valid.

2. Fixed Assets Module

Observation

We noted during our audit of the year 2014 that the fixed assets module in the computerized system included the disposed assets from previous years and can issue several reports that may include inconsistent information, such as different book value, for the same asset item. We understand that this was attributable to the system being relatively old and needs to be updated in order to reflect the actually existing fixed assets with their related values.

This issue may lead to inconsistency in the data generated from the fixed assets module.

Recommendation

In the management letter for the year 2014, we recommended MDLF to review and update the fixed assets module to only include the actually existing fixed assets.

Management Comments

In its response to the management letter of the year 2014, MDLF management stated that the mentioned reports are not reflected in the Trial Balance and have no effect on the financial position of MDLF and that MDLF will contact the software provider to solve this issue.

Current Year's Status

The above recommendation had been implemented by MDLF during the year 2015. Therefore, no further action is required.

3. Internal Audit Function

Observation

We noted during our audit of the year 2014 that no formal internal audit function was existing in MDLF. However, we understand that MDLF was in the process to hire an internal auditor.

Internal audit is considered an important internal control element.

The absence of an internal audit function is considered a weakness in MDLF's internal control system which could lead to having errors or unapproved transactions to occur without being detected and corrected on timely manner.

Recommendation

In the management letter for the year 2014, we recommended management to speed up the process of hiring the internal auditor.

Management Comments

In its response to the management letter of the year 2014, MDLF management stated that MDLF BoD completed the selection process of the Internal Audit Manager at MDLF and he will start his work with MDLF on 26/4/2015.

Current Year's Status

Internal auditor has been appointed by MDLF during the year 2015. Therefore, no further action is required.

4. End of Service Benefits

Observation

We noted during our audit of the year 2014 that the balance of End of Service Benefits (ESB) reserve per accounting records was different from the balance per HR system as of December 31, 2014. We understand that this was due to certain amounts paid in advance to certain employees as part of their ESB allowances. These in advance payments are reflected in the accounting records in separate account but were not reflected in the HR system as of December 31, 2014 due to system technical issues. The difference between the accounting system and the HR system was as follows:

	<u>NIS</u>
Balance per HR system	2,592,738
Balance per accounting records	<u>2,491,434</u>
Difference	<u>101,304</u>

Recommendation

In the management letter for the year 2014, we recommended MDLF to find solutions for the technical issues in the HR system in order to reflect the ESB advance payments in the HR system, and therefore, agree the ESB balance between the two systems.

Management Comments

In its response to the management letter of the year 2014, MDLF management stated that the difference occurred because some employees worked before the establishment of MDLF on projects at the time of the PCU and PTS and they were paid for the end of service from the projects at that time. The payments are recorded in the accounting system but technically we didn't manage to record them in the HR system.

Current Year's Status

During the year 2015, MDLF managed to record the difference in the HR system which brought it in agreement with the accounting system. Therefore, no further action is required.