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**Yazda Global Organization - Iraq**

Dear Sirs,

During our engagement to perform a financial audit of Iraq Program (the Program) implemented by Yazda Global Organization, field office in Duhok for the period from 1 January 2022 to 31 December 2022 in accordance with the International Standards on Auditing, we considered their internal control related to the following cycles: Cash Receipts, Cash Disbursement, and Procurement as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organizations’ internal control. Accordingly, we do not express an opinion on the effectiveness of the organization’s internal control.

Overall, we believe that the controls and procedures put in place by the implementers are adequate and provide a sufficient level of safeguard against anomalies and irregularities in its financial and operational management activities.

Nevertheless, we have identified certain improvements which we feel could be made to further strengthen the controls in these areas, and are now recording them as an attachment to this letter.

Recommended improvements to the internal control and compliance procedures

In the attached appendix we list the matters which we wish to highlight and our recommendations for improvements to the particular issues identified in the current procedures:

This communication is intended solely for the information and use of management and those charged with governance, is not intended to be, and should not be used by anyone other than these specified parties.

We trust that you find the recommendations issued in this letter useful in strengthening Yazda's controls and procedures. Please do not hesitate to contact us if you have any queries in relation to any of the issues raised.

Yours sincerely

Mustafa Abdulghani Qazi Mohamad Street

Partner Italian Village, Villa 25B

Moore Iraq Erbil, Kurdistan, Iraq

01 November 2023

**APPENDIX**

**Description of priority rating**

***Priority 1 - Urgent remedial action is required.*** Key internal controls are absent or are not complied with on a regular basis. There is a fundamental weakness or deficiency in an internal control or in a series of internal controls which involves a substantial risk of either material error, or irregularity with regard to expenditure and revenue stated in the Financial Report of the Project. There is a substantial risk of failure to achieve the control objectives for the Project which concern reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations notably the Contractual Conditions for the Project. Such risks could lead to an adverse impact on the financial report of the Project. Remedial action should be taken urgently.

***Priority 2 - Prompt specific action is required***. There is a weakness or deficiency in an internal control or in a series of internal controls which, although not fundamental, relates to shortcomings which expose specific internal control areas (e.g. cash and bank management or budgetary and expenditure control) to a less immediate level of risk of either error, or irregularity. Such a risk could impact on the effectiveness of the internal controls and on the internal control objectives and should be of concern to the Entity's management. Prompt specific action should be taken.

***Priority 3 - Specific remedial action is desirable***. There is a weakness or deficiency in internal control which individually has no major impact but where the Project would benefit from improved internal controls and/or where the Entity would have the opportunity to achieve greater effectiveness and/or efficiency. There is a possibility of undesirable effects at the process level, which, combined with other weaknesses, could give cause for concern.

**AUDIT RECOMMENDATIONS**

1. **Management Control Finding**

The management control findings are as follows:

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| **Finding n°:** 1 | **Title:** Excessive use of cash |
| **Description of the finding:**  We found that a high volume of payments for various projects were made in cash. and, we found one grant income payment related to the project JIY22 (Ref. YAZ-USD-22-396 dated 19 December 2022) also received in cash.  Whilst we appreciate that the financial environment in Iraq means that the majority of payments are in cash, cash transactions are inherently more risky than other types of transactions due to greater exposure to misappropriation of funds and reduced traceability of expenditure. Therefore, cash policies and internal controls are especially important for projects with a high volume of cash payments to ensure expenditure is appropriate and accurate records can be maintained for financial reporting claims | |
| **Recommendation:**  We recommend that management introduce a payment policy that specifies preferred methods of payment and documentation required (e.g., payment receipts) for these and outlines thresholds for cash payments above which additional explanation and authorization is required. (e.g., Cash transfers should be clearly supported by cash request forms).  This could be achieved by limiting the level of cash payments and petty cash balances held by imposing upper limits. Either bank payments or Hawala system should be used unless this is not possible. | |
| **Recommendation priority:** Priority 1 - Urgent remedial action is required. | |
| **Management Comments:**  As it has been indicated, the financial environment in Iraq and the lack of proper electron system, push many organisations, including Yazda, to relay on cash payments to perform their operations. This is specifically true in our main area of target, Sinjar where no local or international bank operates. However, Yazda has taken improvement steps since last year to ensure the amount of cash payments and transitions are reduced as much as possible. One notable example is that all our local staff salaried have been moved to bank transfer instead of cash payments.  However, we acknowledge the inherent risks associated with cash transactions and fully understand the importance of implementing robust policies and internal controls to mitigate these risks. In light of the audit recommendation, we are committed to addressing the concerns raised and enhancing our financial management practices. We understand the necessity of ensuring the appropriateness of expenditures and maintaining accurate records for financial reporting.  In line with our current finance capacity building plan, we will be implementing the following measures by the next audit:   1. **Introduction of a Payment Policy:** We will develop and implement a comprehensive payment policy that clearly specifies the preferred methods of payment for various transactions. This policy will also outline the documentation requirements, such as payment receipts, to enhance transparency and traceability. 2. **Thresholds and Authorization for Cash Payments:** The payment policy will include specific thresholds for cash payments, above which additional explanation and authorization will be mandatory. Cash transfers will be supported by formal cash request forms to provide a clear audit trail for each transaction. 3. **Limiting Cash Payments and Petty Cash Balances:** To minimize the risks associated with cash transactions, we will impose upper limits on cash payments and petty cash balances. This will help control the volume of cash transactions and reduce exposure to misappropriation of funds. 4. **Preference for Bank Payments or Hawala System:** Unless impractical, we commit to using bank payments or the Hawala system for transactions, thereby enhancing the traceability and accountability of funds. This preference aligns with the goal of reducing reliance on cash transactions.   We believe that these measures will not only address the specific concerns highlighted in the audit finding but will also contribute to an overall improvement in our financial management practices. We appreciate the guidance provided by the audit team and are dedicated to implementing these changes promptly. | |

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| **Finding n°:** 2 | **Title:** Inadequate Accounting System |
| **Observations:**  The organization does not have an accounting system that allows for effective recording of project-related financial transactions The Agency usually uses Excel to record the financial transactions.  However, the organization provided us with a copy of the financial statements issued by the accounting software that is still under development, however, this software could not provide an audit trail that links the costs declared in financial reports to donors with the individual transactions in its accounting software, for the following reasons:  1. The exchange rates used in the accounting software to convert the opening balances of accounts in other currencies into the functional currency (US dollar) are inaccurate.  2. Project reference numbers are incomplete, as there are expense transactions that do not have a reference mark for any project. (e.g., Ref. KIB-EUR1-22-0002, YAZ-USD-22-300, YAZ-USD-22-398, YAZ-USD-22-369, CB-Bank-22-0159).  3. Accounts without account code such as Intercompany - YAZDA US (Income).  4. Accounting treatments need to be reconsidered, such as the treatment of buying and selling fixed assets (Cars Ref. YAZ-USD-22-352 and CB-Bank-22-0103 - an electric generator Ref. CB-Bank-22-0016).  5. Titles of the financial statement components in the reports issued by the accounting software are more suitable for commercial companies than non-profit organizations, for example, the profit and loss statement, and retained earnings).  Lack or incompletion of a proper accounting system represents a significant risk to effective financial management. Without an accounting system, project expenditures may not be accurately recorded, financial reports to donors may not be comprehensive, and double funding or recording of transactions may not be prevented or detected. | |
| **Recommendation:**  The organization should finalize the development of accounting software that allows for the accurate recording of financial transactions from donors. This should include the ability to allocate expenditure by the donor, project, type, and budget line. The accounting system must be capable of producing various financial reports and providing an audit trail that links the costs declared in financial reports to donors with the individual transactions in its accounting system. An accounting software program in financial management and the use of information technology technologies in it will be determined, and this will be done by offering relevant spaces in financial management, and computerized software applications specialized in the field of financial management | |
| **Recommendation priority:** Priority 1 - Urgent remedial action is required. | |
| **Management comment:**  We recognize the importance of maintaining an effective accounting system to ensure accurate financial recording, reporting, and management. Yazda has implemented the Xero Accounting System for its finance management globally. An experienced finance consultant has been hired to help to maintain and improve this system since 2021. This consultant is also providing regular training on the system to Yazda’s Finance Team as and when needed. While we acknowledge the further improvement required for the system to ensure it is used for budget management, expense tracking and reconciliation, we do not agree that the system is inadequate. We will welcome a discussion between the auditor and our finance consultant and finance team to discuss the points highlighted in the auditor finding. In the meantime, we will be committed to review the following points outlined in this audit finding and ensure the right actions are taken where necessary:   1. **Addressing Inaccuracies in Exchange Rates:** We recognize the significance of accurate exchange rates in converting opening balances from other currencies to the functional currency (US dollar). This will be reviewed and the required steps will be taken to rectify this issue and ensure that exchange rates used in the accounting software are precise. 2. **Completing Project Reference Numbers:** We understand the importance of having complete and accurate project reference numbers for expense transactions. This will be reviewed and we will ensure that all transactions are appropriately marked with project reference numbers to enhance transparency and traceability. 3. **Assigning Account Codes:** Accounts lacking proper codes, such as Intercompany - YAZDA US (Income), this will be reviewed and will be assigned appropriate account codes to improve the overall structure and organization of our accounting system. 4. **Reviewing Accounting Treatments:** We will conduct a thorough review of accounting treatments, specifically related to buying and selling fixed assets. This includes revisiting the treatment of transactions involving fixed assets such as cars (Ref. YAZ-USD-22-352) and an electric generator (Ref. CB-Bank-22-0016) to ensure proper accounting practices. 5. **Adopting Non-Profit-Oriented Financial Statements:** This will be fully reviewed as we recognizing the unique nature of our organization as a non-profit entity, we will customize the financial statement components in our accounting software to better align with non-profit standards. This includes renaming components such as the profit and loss statement and retained earnings. 6. **Enhanced Reporting Capabilities:** The accounting software has the functionality to allow for the allocation of expenditures by donor, project, type, and budget line. This will enable the generation of various financial reports to meet the specific requirements of donors and internal stakeholders. 7. **Implementation of Audit Trail:** This is acknowledged and will be fully reviewed accounting system will be enhanced to provide a robust audit trail linking costs declared in financial reports to donors with individual transactions. This measure is crucial for accountability and transparency. | |

1. **Compliance Finding**

We have not raised any compliance findings.