

CONSTANTA FOUNDATION
FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT

DECEMBER 31, 2001

CONSTANTA FOUNDATION
YEAR ENDED DECEMBER 31, 2001

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THE MILLER GROUP

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
**Constanta Foundation and
Save the Children - Georgia**
Tbilisi, Georgia

We have audited the accompanying balance sheet Constanta Foundation as of December 31, 2001, and the related statements of income and cash flows for the year then ended. These financial statements are the responsibility of Constanta's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the financial position of Constanta as of December 31, 2001 and the results of their activities, changes in donated equity, and their cash flows for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated April 24, 2002, on our consideration of Constanta's internal control over financial reporting and our tests of its compliance with certain provisions of United States laws, regulations, contracts and grants.

INDEPENDENT AUDITOR'S REPORT (continued)

Our audit was performed for the purpose of forming an opinion on the basic financial statements of Constanta taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Government, and Non-Profit Organizations*. The supplementary information on pages 18 through 19 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.


The Miller Group, CPAs

April 24, 2002
Washington, DC

CONSTANTA FOUNDATION
BALANCE SHEET
AS OF DECEMBER 31, 2001

ASSETS

Current assets:

Cash and cash equivalents on deposit in local banks and on hand	\$ 560,872
Loans, net of allowance for loan losses of \$28,643	1,403,517
Other current assets	<u>114,297</u>
Total current assets	2,078,686

Non-current assets:

Property, equipment and vehicles, net of accumulated depreciation and amortization	<u>370,972</u>
Total assets	<u>\$ 2,449,658</u>

LIABILITIES AND EQUITY

Current liabilities:

Accounts payable	732
Other liabilities	<u>1,301</u>
Total liabilities	<u>2,033</u>

Equity:

Accumulated donations	2,227,334
Operating retained earnings	166,155
Cumulative foreign currency adjustments	<u>54,136</u>
Total equity	<u>2,447,625</u>
Total liabilities and equity	<u>2,449,658</u>

See notes to financial statements.

CONSTANTA FOUNDATION
STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2001

Interest income:	
Interest and fees on loans	\$ 790,535
Interest from short-term investments	35,725
	<u>826,260</u>
Total interest income	
Provision for loan losses	<u>26,499</u>
Net interest income after provision for loan losses	799,761
Non-interest expense	
Salaries and benefits	401,295
Administrative expenses	154,365
Depreciation	25,390
Other expenses	2,930
Total non-interest expenses	<u>583,980</u>
Net operational income	215,781
Grant income	<u>396,436</u>
Net income after grants	<u>\$ 612,217</u>

See notes to financial statements.

CONSTANTA FOUNDATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2001

Cash Flows from Operating Activities:	
Income from operating activities	215,781
<i>Adjustments to reconcile net operating income to net cash provided from operating activities</i>	
Provision for loan losses	26,499
Depreciation and amortization expense	25,390
(Increase) in other current assets	(8,222)
(Increase) in loan portfolio	(764,982)
Increase in accounts payable and other liabilities	<u>997</u>
Net cash provided by operating activities	<u>(504,537)</u>
 Net Cash Flows used by Investing Activities:	
Accumulated donations	656,012
Foreign currency adjustments	35,952
Purchase of property and equipment	<u>(297,834)</u>
	394,130
Total adjustments	(110,407)
Cash and cash equivalents, January 1, 2001	<u>671,279</u>
Cash and cash equivalents, December 31, 2001	<u><u>560,872</u></u>

There are no non-cash investing or financing activities for the year ended December 31, 2001.

CONSTANTA FOUNDATION
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2001

1. ORGANIZATION

Nature of Business:

Constanta Foundation (Constanta or the Organization) is a micro-finance institution providing small, short-term sustainable financial services to economically active, self-employed citizens of Georgia, with a primary focus on economically disadvantaged women micro-entrepreneurs.

Constanta was registered in January 1997 as a not-for-profit organization under Georgian law and started lending operations in October 1997. Constanta re-registered itself as a not-for-profit foundation in January 1999 in compliance with a new Georgian law regulating non-governmental organizations (NGOs).

The Organization operates 4 branch offices in Georgia. Constanta's primary source of revenue is derived from providing loans to clients located in Georgia. The loans are of two types – individual loans and group loans.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting:

The accompanying financial statements are prepared in accordance with generally accepted accounting principles and presented on the accrual basis, which require revenue to be recognized when earned and expenses to be recorded when incurred.

Basis of Presentation:

Support and revenue are recognized when the grantor has obligated the grant award in accordance with SFAS No. 117. The reporting currency is United States Dollars (USD).

Cash and cash equivalents:

As of December 31, 2001, Constanta maintains \$374,975 of term deposits with a Georgian financial institution. These term deposits are short-term with an average yield of approximately 10% per annum. These deposits are highly liquid and are considered cash equivalents for the purposes of the statement of cash flows.

CONSTANTA FOUNDATION
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2001 (continued)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment:

Property and equipment are recorded at cost and depreciated over the estimated useful lives of 5-10 years using the straight-line method for depreciation. Gains or losses, if applicable, on the sale of fixed assets owned by the Organization, are recognized upon the disposal of such assets.

Repairs and maintenance that do not extend the useful lives of assets are expensed in the year in which they are incurred. Leasehold improvements are recorded as an addition to building costs and amortized over the estimated useful life of the building, which is 20 years.

Grants, grants receivable and donated equity:

Grants to subsidize operating and administrative expenses are recorded in the statement of income as donation/grant income. Grants to finance lending operations or for the purchase of property and equipment are shown as direct additions to donated equity and the corresponding asset account. Grants receivable consist of the balance of grants and sub-grants awarded or due to Constanta as of December 31, 2001 but not yet received by the Organization although committed.

As of December 31, 2001 the United States Agency for International Development (USAID) through Save the Children Federation, Inc. (SCF) awarded Constanta \$873,835, of which \$824,804 has been received. This grants receivable has been recorded at the awarded amount in US dollars on the date of the unconditional promise to give was received by the Organization.

Donated equity receivable, if any, consists of grants committed to finance lending operations or for the purchase of property and equipment. As of December 31, 2001, grants receivable consisted of the following:

Grantor	Total grant receivable	Donated equity	Operating grant
SCF/USAID	\$ 49,031	\$ 12,900	\$ 36,131

On March 15, 2002, the Organization received \$44,498 of the outstanding grant receivable from SCF. Of this amount, \$9,571 were expenses incurred relating to the year ended December 31, 2001 but not reimbursed by SCF until after December 31, 2001. The remaining unpaid balance of \$4,533 is expected to be received by Constanta on or about April 30, 2002.

CONSTANTA FOUNDATION
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2001 (continued)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates:

The preparation of the financial statements in conformity with generally accepted accounting standards requires management to make estimates and assumptions that affect reported assets and liabilities as well as reported income and expenses. A material estimate that is particularly susceptible to significant change relates to the determination of the provisions for loan losses.

Loans, allowance for loan losses, interest accrual and charge-offs:

Loans are shown in the balance sheet, net of the allowance for loan losses. Interest on loans is accrued on the principal amount of loans outstanding. Interest on group loans is calculated using the simple interest method on weekly balances of the original principal amount. Interest on individual loans is computed on the principal balances outstanding.

Management regularly evaluates the adequacy of the allowance for loan losses. Factors considered in evaluating the adequacy of the allowance include the size of the portfolio, previous loss experience, current economic conditions and their effect on borrowers, the financial condition of individual clients, and the performance of individual loans in relation to contract terms. The allowance for loan losses charged to expense is based on management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb losses.

Management provides for potential loan losses on an ongoing basis, at least every month in order to maintain the allowance for loan losses at adequate levels. The adequacy of the allowance for loan losses is determined by applying defined percentages to the outstanding balances in various aging categories as shown below:

LOAN STATUS	ALLOWANCE (Percentage)
8 - 30 days overdue	5
31 - 60 days overdue	25
61 - 90 days overdue	50
91 - 270 days overdue	70
Over 270 days overdue	100

Constanta is not a financial institution and currently is not a regulated industry. Its allowance for loan losses policy is based on management's analysis of the historical performance of the overdue portfolio, aged by loan category. In addition to the percentages above, a general allowance for loan losses is recorded to take into account environmental, political and industry concentrations. The overall general allowance for loan losses is approximately 2% of the outstanding loan portfolio and is consistent with industry standards.

CONSTANTA FOUNDATION
NOTES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2001 (continued)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans, allowance for loan losses, interest accrual and charge-offs (continued):

Loan losses (charge-offs) are charged against the allowance for loan losses when management believes the principal is unlikely to be collected and all measures of internal collection have been exhausted. Loans that have been overdue more than 270 days are automatically charged off.

Foreign currency:

The Organization maintains seven (7) separate accounts denominated in US dollars (USD) and thirteen (13) separate accounts denominated in Georgian Lari (GEL) in six (6) different Georgian financial institutions. In order to minimize the potential of any foreign currency fluctuation exposure and credit concentration risk to Constanta, USD are converted into GEL as advanced from Save the Children Federation, Inc. For financial reporting purposes, the Organization records all transactions in GEL, however, all USAID reports are prepared in USD utilizing the exchange rate in effect at the time the advance was received and converted by SCF.

For the purposes of foreign currency translation adjustments, the exchange rate between GEL and USD as of December 31, 2001 was approximately 2.15 to \$1. The average exchange rate between GEL and USD during the year ended December 31, 2001 was approximately 2.10 to \$1. Since all grants funds are disbursed to Constanta in GEL, there are no material foreign currency transaction gains or losses for the year ended December 31, 2001. Cumulative foreign currency translation adjustments are shown on the balance sheet as an adjustment to equity and totaled \$54,136 as of December 31, 2001.

Indirect cost allocation:

Constanta allocates indirect costs to its financial services activities in accordance with OMB Circular A-122. Significant indirect costs not directly reimbursed by a grant/funder are allocated as a percentage of direct salaries and related salary expenses dedicated to financial services activities to total salaries and related salary expenses.

Income taxes:

The Organization is not subjected to value added tax (VAT) on capital expenditures from grant funds. Constanta is entitled to a refund of \$25,661 of VAT taxes paid on these expenditures from the taxing authority and these refunds can be used to offset VAT tax on future capital expenditures. Management has not recorded an allowance for these refunds since realization in the future is likely. Constanta is not currently subjected to Georgian income tax on the monthly gross income on earnings from lending and finance activities since it relates to income generated from grant funding and is part of the cost-sharing agreement between USAID and SCF.

CONSTANTA FOUNDATION
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2001 (continued)

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalent balances as of December 31, 2001 are as follows:

Type of Cash	Amount
Cash in Georgian banks	\$ 174,894
Cash in safe	\$ 11,203
Total cash in banks and in safe	\$ 185,897
Cash equivalents – term deposits	\$ 374,975
Total cash and cash equivalents	\$ 560,872

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loan balances as of December 31, 2001 are as follows:

Type of Loan	Amount
Number of active loans	13,087
Individual loans	\$ 115,361
Group loans	\$ 1,316,799
Loan portfolio before allowance	\$ 1,432,160
Allowance for loan losses	\$ 28,643
Net loan portfolio	\$ 1,403,517

The average loan portfolio before the allowance for loan losses, calculated monthly, was \$823,825 during the year ended December 31, 2001. Changes in the provisions for loan losses are summarized as follows:

Item	Amount
Balance, January 1, 2001	\$ 6,809
Provision for loan losses for 2001	\$ 26,499
Loans charged off during 2001	\$ 4,665
Balance, December 31, 2001	\$ 28,643

CONSTANTA FOUNDATION
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2001 (continued)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The principal balance of past-due loans on December 31, 2001 are as follows:

Past Due	Amount
Number of delinquent borrowers	917
8 days to 30 days	\$ 5,391
31 days to 60 days	\$ 4,606
61 days to 90 days	\$ 1,112
91 days to 270 days	\$ 3,892
Greater than 270 days	\$ 1,982
Total past due loans	\$ 16,893

During the year ended December 31, 2001, recoveries of previously charged-off loans totaled \$520.

Constanta had \$89,258 commitments to lend additional funds, which had not been disbursed as of December 31, 2001.

5. OTHER CURRENT ASSETS

Other current assets as of December 31, 2001 are as follows:

Type of asset	Amount
Prepaid expenses	\$ 18,534
Miscellaneous receivables	\$ 13,647
Accrued interest receivable	\$ 7,424
Grants receivable – SCF/USAID	\$ 49,031
Value added tax refunds due	\$ 25,661
Total	\$ 114,297

CONSTANTA FOUNDATION
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2001 (continued)

6. PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2001 are summarized below:

Type of asset	Amount
Building and improvements	\$ 241,144
Furniture and office equipment	\$ 89,125
Computer equipment and peripherals	\$ 60,810
Vehicles	\$ 28,887
Sub-total	\$ 419,966
Accumulated depreciation and amortization	\$ (48,994)
Total	\$ 370,972

Depreciation and amortization expense for the year ended December 31, 2001 totaled \$25,390.

7. CHANGES IN EQUITY AND DONATED EQUITY

As of December 31, 2001, equity consisted of the following:

Indicator	Balance January 1, 2001	Additions (Reductions)	Balance December 31, 2001
Donations – recorded directly to the balance sheet	\$ 1,172,584	\$ 259,576	\$ 1,432,160
Grants – recorded through the income statement	\$ 398,738	\$ 396,436	\$ 795,174
Subtotal	\$ 1,571,322	\$ 656,012	\$ 2,227,334
Retained operating income (accumulated deficit)	\$ (49,626)	\$ 215,781	\$ 166,155
Cumulative foreign currency adjustments	\$ 18,184	\$ 35,952	\$ 54,136
Total equity	\$ 1,539,880	\$ 907,745	\$ 2,447,625

CONSTANTA FOUNDATION
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2001 (continued)

7. CHANGES IN EQUITY AND DONATED EQUITY

Donations recorded directly to the balance sheet consisted of:

	SCF/USAID	UNHCR	Total
Donated equity, January 1, 2001	\$ 1,172,584	\$ 0	\$ 1,172,584
Loan portfolio	\$ 237,513	\$ 0	\$ 237,513
Capital expenditures	\$ 16,463	\$ 5,600	\$ 22,063
Donated equity, December 31, 2001	\$ 1,426,560	\$ 5,600	\$ 1,432,160

8. COMMITMENTS AND CONTINGENCIES

Constanta was awarded a sub-grant from Save the Children Federation, Inc/USAID, in the amount of \$873,835 to provide support for the project *"Increasing Access to Financial Services for Poor Women Micro-entrepreneurs in Georgia"*. This grant terminates on August 31, 2002 and contains certain disbursement, budgetary and other restrictions. As of December 31, 2001,

\$824,804 has been received by the Organization and \$49,031 of the remaining grant amount had not been received (see Note 2).

On July 27, 2001, Constanta was awarded and received a grant from the International Bank for Reconstruction and Development (World Bank) for the Consultative Group to Assist the Poorest (CGAP) for \$50,000. These funds are to be used solely for the mobile lending program for the central purpose to further the industry's learning and knowledge on financial products and methodologies that reach very poor populations, reduce vulnerability and increase their economic well being.

Constanta was awarded and received a grant from The United Nations High Commissioner for Refugees (UNHCR) for \$324,901 (*original grant was for \$330,000 but was subsequently reduced by \$5,099. This amount remained unspent from a previous grant and in lieu of returning these funds, Constanta elected to reduce the new grant by this amount*) for operating expenses to enable the Organization to achieve its operational sustainability towards the end of 2001 and to create a sustainable financial institution within 2-3 additional years. Additionally, UNCHR allowed Constanta the right to use \$7,296 of listed computer and office equipment for the implementation of UNCHR approved programs.

CONSTANTA FOUNDATION
 NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED DECEMBER 31, 2001 (continued)

8. COMMITMENTS AND CONTINGENCIES (continued)

The Organization is committed under operating leases for office space as follows:

Type of Lease	Lease Term	Monthly Payment	Remaining Commitment
Office space - Isani Branch	July 27, 2001 to June 27, 2002	\$1,250, including taxes	\$ 7,500
Office space - Batumi Branch	November 1, 2001 to October 1, 2002	\$913, including taxes	\$ 8,217
Office space - Gori Branch	June 18, 2001 to May 18, 2002	\$500, including taxes	\$ 2,500
Office space - Marneuli Branch	August 16, 2001 to December 31, 2002	\$150, including taxes	\$ 2,475
Office space - Tsnori Branch	December 23, 2001 to December 31, 2002	\$50, including taxes	\$ 600
Totals		\$ 2,863	\$ 21,292

In the ordinary course of business, Constanta is committed under various contracts including employment agreements, cleaning and maintenance, and security. With the exception of employment agreements, contracts for outside services usually do not exceed one-year terms and are renewable at the Organization's sole discretion.

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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors
Constanta Foundation
Save the Children Federation, Inc. - Georgia
Tbilisi, Georgia

We have audited the financial statements and supplemental information of Constanta Foundation as of and for the year ended December 31, 2001, and have issued our report thereon dated April 24, 2002. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Constanta's financial statements and supplemental information are free of material misstatement, we performed tests of its compliance with certain provisions of applicable US laws and Federal regulations as they would apply to international sub-recipients of Federal grants, specific contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS (CONTINUED)

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements and supplemental information of Constanta for the year ended December 31, 2001, we considered Constanta's internal control over financial reporting, branch reporting and lending procedures in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we considered to be reportable conditions. *Reportable conditions* involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Constanta's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs on pages 21-27.

A *material weakness* is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of the Board of Directors, management, and pass-through entities. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

April 24, 2002
Washington, DC



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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors
Constanta Foundation
Save the Children Federation, Inc. - Georgia
Tbilisi, Georgia

Compliance

We have audited the compliance of Constanta Foundation with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to foreign sub-recipients relating to Constanta's major federal program for the year ended December 31, 2001 (activities allowed or un-allowed, allowable costs, eligibility, matching, period of availability of Federal funds and required reporting). Constanta's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of applicable US laws and Federal regulations, contracts and grants applicable to its major federal program is the responsibility of Constanta Foundation's management. Our responsibility is to express an opinion on Constanta Foundation's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Constanta's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Constanta's compliance with those requirements.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

In our opinion, Constanta Foundation complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2001.

Internal Control Over Compliance

The management of Constanta Foundation is responsible for establishing and maintaining effective internal control over compliance with requirements of applicable US laws and Federal regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Constanta's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable US laws and Federal regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of the Board of Directors, advisory committees, management, Federal awarding agencies and pass-through entities. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

April 24, 2002
Washington, DC



CONSTANTA FOUNDATION
SUPPLEMENTAL INFORMATION
SCHEDULE OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2001

<u>Organization/Agency</u>	<u>Award Number</u>	<u>Total Allowable Expenditures</u>
MAJOR AWARDS:		
SCF/USAID	PCE-A-00-89-00026-00	<u>\$ 834,375</u>

See Report of Independent Auditor.

CONSTANTA FOUNDATION
SUPPLEMENTAL INFORMATION
CALCULATION OF INDIRECT COST RATE
FOR THE YEAR ENDED DECEMBER 31, 2001

Description of expense	Expenses DIRECTLY related or DIRECTLY reimbursed by grant for financial services program	Expenses INDIRECTLY related (but not reimbursed by grant) for financial services program administration	Total
Salaries	\$ 322,179	\$ 59,340	\$ 381,519
Benefits and related costs	15,689	3,087	19,776
Sub-total	<u>\$ 338,868</u>	<u>\$ 62,427</u>	<u>\$ 401,295</u>
Direct allocation percentage based on salaries	<u>04.44%</u>	<u>15.56%</u>	<u>100%</u>
Occupancy	\$ 49,806	-	\$ 49,806
Office supplies	15,832	2,917	18,749
Legal services	0	1,162	1,162
Communications	9,665	1,781	11,446
Repairs and maintenance	6,457	1,190	7,647
Bank charges	5,395	994	6,389
Depreciation	0	25,390	25,390
Staff training	19,885	3,626	23,511
Consulting	990	-	990
Miscellaneous	19,218	1,702	20,920
Insurance	703	130	833
Travel and transportation	11,813	1,299	13,112
Taxes	0	2,930	2,930
Sub-total	<u>139,585</u>	<u>43,120</u>	<u>182,685</u>
TOTALS	<u>\$ 478,453</u>	<u>\$ 105,547</u>	<u>\$ 583,980</u>

INDIRECT COST RATE CALCULATION:		
Total indirect expenses	\$ 105,547	Direct expense - expense directly benefits and relates to financial services. These expenses would include financial services related salaries, branch rent, etc. Indirect expense - expenses that indirectly benefit the financial services program. These would include communications, office supplies, etc.
Total expenses	\$ 583,980	
Indirect cost rate:	<u>18.07%</u>	

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001

Part I: Summary of Audit Results

1. The auditor's report expresses an unqualified opinion on the financial statements of Constanta Foundation as of and for the year ended December 31, 2001.
2. Reportable conditions in internal control are summarized on pages 22-23. There were no material weaknesses in internal control disclosed during the audit of the financial statements.
3. The audit disclosed no instances of non-compliance, which were material to the financial statements of Constanta Foundation.
4. The audit report expresses an unqualified opinion on compliance for major programs of Constanta Foundation.
5. No reportable conditions or material weaknesses in internal control for major programs were disclosed by the audit of the financial statements.
6. The programs identified as Type A and tested as a major federal program are:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
PCE-A-00-99-00026-00	SCF/USAID

7. Threshold used to distinguish to between Type A and Type B programs was \$300,000.
8. Constanta was determined to be a high-risk auditee due to the volume and type of transactions.

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001 (continued)

Part II: Findings – Financial Statement Audit (GAGAS)

None

Part III: Audit Findings and Questioned Costs (Major Programs – Circular A-133)

Current year questioned costs: There were no questioned costs as defined by OMB Circular A-133 which incorporates OMB Circular A-122 by reference for the year ended December 31, 2001.

Current year reportable conditions:

1. Constanta currently calculates the allowance for loan losses utilizing historical collection data only, which is limited since Constanta is a relatively new micro-finance institution (1997). The Organization's current allowance for loan losses is less than .50% of the outstanding loan portfolio and their annual provision is based solely on the current year's actual losses. This procedure may result in an overall understatement of the allowance for loan losses since unanticipated political, environmental, regulatory, portfolio concentration in one type of borrower and other unknown variable factors are not taken into consideration. The allowance for loan losses purpose is to provide for any future unknown and unanticipated losses that *could or might occur*, not only those that have occurred, given the current lending practices of the Organization. The micro-finance industry statistics indicate an overall allowance for loan losses of 2% of the outstanding loan portfolio should be used to account for these unknown variables and to adequately reflect variable factors as they affect the loan portfolio as a whole.
2. During 2002, Constanta changed its basis of financial reporting from the cash basis to the accrual basis of accounting to comply with generally accepted and international accounting standards. Adopting these standards will now require the Organization to accrue interest on outstanding loans as earned, not necessary when the loan is paid. There currently is no policy in effect for accrual of interest on past-due loans. A policy of past due loans in excess of 90 days should be placed on a "non-accrual" status until the loan has been restructured or future collection can be assured and stabilization of the loan as a performing asset occurs.

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001 (continued)

Part III: Audit Findings and Questioned Costs (Major Programs – Circular A-133) (continued)

Current year reportable conditions (continued):

For example, if a loan becomes delinquent on principal or interest for 90 days or more, the loan is placed on non-accrual status. Interest received on a non-accrual loan is applied to principal first or, if management determines that the principal is collectible, applied to interest when received. A loan may be returned to accrual status after the borrower has brought the loan current and demonstrated compliance with the loan terms for a sufficient period and management's doubts as to collectibility have been removed.

3. Currently the computerized financial accounting records do not interface with the loan and lending computerized records. Constanta manually reconciles the outstanding loan reports in total and records the totals into the financial accounting records. If possible and cost effective, the current computer software should be modified so that the computerized loan records automatically record the necessary accounting entries. If the current computer software can not be modified, then the Organization should consider purchasing software specifically designed for and by the micro-finance industry that will enable this interface and enhance current reporting. Additionally, as the Organization continues to expand and grow, this enhancement will expedite the reconciliation process and enable Constanta to readily produce management and financial reports.
4. Constanta maintains several bank accounts at different banks; however, no separate account used exclusively for United States federal funds was identified. In accordance with OMB Circular A-133, federal grants and sub-grants should be maintained in a separate bank account and segregated in the safe from other Organizational funds. Draws against sub-grants should not materially exceed the immediate needs of the Organization in order to minimize any risk associated with excess cash on hand and/or on deposit with financial institutions.
5. The Organization currently invests cash reserves in "certificates of deposits" or term deposits. Although the annual yield on these types of investments are somewhat higher than one would expect, no written policy is in place to evaluate and direct investing of excess cash or cash reserves. We recommend a written investment policy that include type of investments allowed, concentration of the investment, risk assessment of the investment, and projected rate of return.

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001 (continued)

Part III: Audit Findings and Questioned Costs (Major Programs – Circular A-133) (continued):

Status of Prior Year Recommendations (Note – these recommendations were prepared by GCG, a Georgian accounting firm and ICP, an independent consultant. Included in this report are the recommendations made and included in their reports issued to management that we agree have an impact to the internal control of Constanta.)

- **Increase monitoring of interrelationships amongst group members operating same type of business.**

Status and Management's response:

Constanta's lending policy indicates that the Organization limits participation of family members in one group or participation of clients having the same business. The exception can be made only under special circumstances with written and prior approval of Constanta management. If and when this kind of exception is made, then the information is disclosed and is communicated in writing to the group members. Constanta then segregates this loan and monitors it separately from the rest of the portfolio.

- **Establish collateral receipt and monitoring system for group loans.**

Status and Management's response:

Group loans, are by definition, do not require standard types of collateral. These loans are designed for poor clients, which do not have standard (from a commercial bank's point of view) valuable collateral making this "group" ineligible for commercial credit. If a group loan should become past due, Constanta has strict policies and procedures for obtaining, retaining and liquidating collateral. Additionally, each group member is individually and severally liable for repayment of the loan, therefore enhancing Constanta's repayment position.

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001 (continued)

Part III: Audit Findings and Questioned Costs (Major Programs – Circular A-133) (continued):

Status of Prior Year Recommendations (continued)

- Increase security control over cash for Batumi branch.

Status and Management's response:

The above-mentioned recommendation has already been implemented. Batumi branch clients pay directly to the bank where Constanta has special account.

- Consider quality, type and value of collateral and lack thereof when calculating loan loss reserve.

Status and Management's response:

See Reportable Condition 1.

- Focus on liquidity available for weekly installments. Perform site visits for data collection. Include historical cash flow analysis when underwriting individual loans.

Status and Management's response:

The above-mentioned recommendation has been implemented. Site visits for data collection and historical cash flow analysis, when historical data is available, are also being implemented.

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001 (continued)

Part III: Audit Findings and Questioned Costs (Major Programs – Circular A-133) (continued):

Status of Prior Year Recommendations (continued)

- Develop additional marketing strategies such as flyers, radio, newspaper announcements, and strategic alliances to enhance product offerings and public awareness.

Status and Management's response:

Additional marketing strategy has been developed and included in Strategic Plan. Constanta has advertisements through both printed and visual media.

- Dual control procedures should be established to enhance internal control of cash on premises. Improve documentation on individual loan procedures and objectives and make these individual loans part of Internal Audit cycle.

Status and Management's response:

Constanta has implemented this recommendation.

- Develop Internal Audit Plan for financial services provided and develop detailed audit report for branch visits.

Status and Management's response:

Internal Audit plan as well as detailed Audit report for branch visits has been developed. A branch rotation plan has been incorporated and rotation of each specific bank operational function is subjected to internal audit. An internal audit schedule has been prepared by Constanta's internal auditor.

CONSTANTA FOUNDATION
Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2001 (continued)

Part III: Audit Findings and Questioned Costs (Major Programs – Circular A-133) (continued):

Status of Prior Year Recommendations (continued)

- Provide or obtain training program for internal audit department.

Status and Management's response:

An Internal Audit Department and Audit Committee could be created if number of employees is over 110. Currently, Constanta has less than 110 employees and only one staff member is responsible for the internal audit function. Although Constanta is fully aware of the need of an internal audit department when the volume and types of transactions warrant, due to their size at the present time, no internal audit department or audit committee has been established, however; once it becomes apparent that the need is imminent, implementation of this recommendation will happen immediately.

- Interface file server with client server. Enhance individual lending data handling in order to make it readily available through the MIS system. Periodic training of IT staff.

Status and Management's response:

Constanta has already done some preparation work so to be ready for moving into other system as soon as the number of utilized computers exceeds 50. IT staff attends training session on a regular bases. See Reportable Condition 3.