UNITED NATIONS DEVELOPMENT PROGRAMME
Office of Audit and Investigations

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AUDIT

OF

UNDP AFGHANISTAN

Local Governance Project

(Project No. 90448)

Report No. 1745

Issue Date: 23 December 2016

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Report on the Audit of UNDP Afghanistan
Local Governance Project (Project No. 90448)
Executive Summary

The UNDP Office of Audit and Investigations (OAI), from 13 to 24 November 2016, conducted an audit of the Local Governance Project (Project No. 90448) (the Project), which is implemented by the UNDP Country Office in Afghanistan (the Office). The audit aimed to assess the adequacy and effectiveness of the governance, risk management and control processes relating to the following areas and sub-areas:

(a) governance and strategic management (organization and staffing, organizational structure and delegations of authority, leadership/ethics and values, and planning);

(b) programme activities (programme management, partnerships and resource mobilization, project management); and

(c) operations (human resources, finance, procurement, general administration and assets).

The audit covered the activities of the Project from 1 October 2015 to 11 November 2016. The Project recorded project expenditures of approximately $6.5 million during this period. This was the first audit of the Project. An audit of its predecessor project, the Afghanistan Sub-National Governance Programme (ASGP) (Project No. 58922), was conducted in August 2014 and was rated as "unsatisfactory" (OAI Audit Report No. 1408 issued on 28 January 2015). Given that follow-up audit of ASGP was not possible as that project closed in July 2015, OAI agreed with the Office's management that the successor project would be audited.

The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Overall audit rating

OAI assessed the Project as **partially satisfactory**, which means, "Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity." This rating was mainly due to weaknesses in project management and assets management.

Key recommendations: Total = **8**, high priority = **2**

Objectives	Recommendation No.	Priority Rating
Achievement of the organization's strategic objectives	1	Medium
Reliability and integrity of financial and operational information	6	Medium
Effectiveness and efficiency of operations	7	Medium
Safeguarding of assets	8	High
Compliance with legislative mandates, regulations and rules, policies and procedures	3, 4, 5	Medium
	2	High

For high (critical) priority recommendations, prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP. Both high (critical) priority recommendations are presented below:

Project assurance mechanisms not fully implemented (Issue 2)	The Office had established an assurance monitoring plan. However, it was not fully implemented, as explained below: ▪ Programmatic monitoring and field visits were not regularly conducted as stipulated in the assurance plan. The Office had planned to engage an audit firm to undertake this monitoring. However, as at November 2016, the audit firm was not yet contracted. ▪ Periodic on-site reviews (spot checks) of the implementing partner's financial transactions were not conducted though required to be undertaken three times per year. ▪ Procurement status reporting based on the procurement plan was also not undertaken. The OAI audit of the predecessor project ASGP (OAI audit report no. 1408) had also identified weaknesses in monitoring project activities (issue 4). <u>Recommendation:</u> The Office should enhance controls over project assurance by: (a) hiring the audit firm at the earliest to undertake monitoring at the provinces and municipalities; and (b) undertaking regular monitoring and spot checks as per the project assurance plan at the central and provincial levels.
Costs for use and transfer of project vehicles not recovered (Issue 8)	The Office had 19 vehicles with a purchase value of $2.9 million. The following was noted with regard to non-compliance with UNDP cost-recovery policies and procedures: ▪ Seven vehicles with a purchase (or acquisition) value of $0.9 million were located at Regional Offices and used by the regional teams from other projects and the Office as part of pooled resources. However, their cost had not been recovered. ▪ The ownership of nine armored vehicles with a total net book value of $0.4 million was transferred to the Office in August 2016, with zero cost. There was no written justification found for the zero cost transfer. <u>Recommendation:</u> The Office should ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on cost recovery relating to the use and transfer of project vehicles. This should include: (a) recovering the associated costs of using the seven vehicles until August 2016 and considering transferring the ownership of the remaining four vehicles in the regions to the Office; and (b) reimbursing the Project for the net book value of the nine vehicles as appropriate.

Management comments and action plan

The Resident Representative accepted all eight recommendations and is in the process of implementing them. Comments and/or additional information provided had been incorporated in the report, where appropriate.

Issues with less significance (not included in this report) have been discussed directly with management and actions have been initiated to address them.

Antoine Khoury
Officer-in-Charge
Office of Audit and Investigations

I. About the Office

The Office is located in Kabul, Afghanistan. The total management and programmatic expenditures of the Office during the period from January to November 2016 amounted to $456 million. Globally, the Office delivers UNDP's largest programme, in one of the world's most insecure environments, with unparalleled challenges made even more difficult because of the security, political and socio-economic transition facing the Country.

The Project is funded by multiple donors, and focusses on supporting the Government in strengthening institutional structures at the central, provincial and municipal levels. The Project is nationally implemented with support from the Office. The main Government partner for the Project is the Independent Directorate for Local Governance. The Project team is based in Kabul, while a third-party contractor has been engaged to support the implementation of activities at the provincial and municipal levels.

II. Audit results

Satisfactory performance was noted in the following area:

(a) Procurement: Procurement activities of the Project were undertaken by the Office. The review of the procurement activities did not find any reportable issues.

OAI made two recommendations ranked high (critical) and six recommendations ranked medium (important) priority.

Low priority issues/recommendations were discussed directly and agreed with the Office and are not included in this report.

High priority recommendations, arranged according to significance:

(a) Enhance controls over project assurance (Recommendation 2).
(b) Ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on cost recovery relating to the use and transfer of project vehicles (Recommendation 8).

Medium priority recommendations, arranged according to significance:

(a) Enhance the oversight function by ensuring Project Board and programme management meetings are held regularly (Recommendation 1).
(b) Establish procedures to address delays in project implementation (Recommendation 3).
(c) Accelerate the recruitment of the Monitoring and Evaluation Specialist, streamline the reporting format, and ensure the timely submission of progress reports to donors (Recommendation 4).
(d) Enhance controls over the recovery of costs from the Project (Recommendation 5).
(e) Ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on the management of project cash advances (Recommendation 6).
(f) Ensure timely completion of mandatory courses (Recommendation 7).

The detailed assessment is presented below, per audit area.

A. Governance and Strategic Management

Issue 1 Project Board and programme management meetings not held as planned

According to the 'UNDP Programme and Operations Policies and Procedures', the Project Board is responsible for making, by consensus, management decisions for a project when guidance is required by the Project Manager, including approval and revisions of project Annual Work Plans. Further, the Project Document indicates that Project Board meetings are to be held quarterly.

The audit team noted that the Project Board met only twice during the period from October 2015 to November 2016. Further, no meeting minutes were provided to OAI to indicate that the 2016 Annual Work Plan was approved by the Project Board.

The Project was facing a number of challenges such as security risks that hampered field monitoring, and delays in the receipt of donor funds that impacted the implementation of planned activities, which were considered beyond the control of the Project Manager. However, Project Board meetings were still not held to discuss these challenges and possible solutions. In response to the audit fieldwork, the Office's management indicated that it had been a challenge arranging the planned four Project Board meetings a year, primarily due to the security situation. However, the Office continued to engage at the appropriate levels with all stakeholders, including the implementing partner. The Office also stated that the bi-annual meetings, with options for additional ad-hoc meetings as required, would be recommended at the next Project Board meeting.

Similarly, programme management meetings were scheduled to be held monthly. However, only a total of four meetings were held during the audit period. The programme management meetings were intended to assess the alignment of activities with the Annual Work Plan, and contributions to the pillar outputs.

The OAI audit of the predecessor project ASGP (OAI audit report no. 1408) had also identified weaknesses in monitoring project activities (issue 5).

By not holding regular Project Board and programme management meetings, project risks and challenges might not be addressed timely. This could negatively affect the achievement of the Project's intended results.

Priority	Medium (Important)
Recommendation 1: The Office should enhance the oversight function by ensuring Project Board and programme management meetings are held regularly, and escalating issues beyond the control of the Project Manager to the Project Board.	
Management action plan: At the next Project Board meeting, the Office will propose to reduce the frequency of Project Board meetings from four to two times per year. **Estimated completion date:** 31 March 2017	

B. Project Management

Issue 2 Project assurance mechanisms not fully implemented

According to the 'UNDP Programme and Operations Policies and Procedures', the project assurance role supports the Project Board by carrying out objective and independent project oversight and monitoring functions. This ensures appropriate project management milestones are managed and completed. A UNDP Programme Officer typically holds the project assurance role. As part of the assurance function, a representative from the Country Office should visit each project at least once a year. Field visits help validate results and should provide the latest information on progress for annual reporting preparation.

The Office developed an assurance plan for 2016 that outlined the following activities to be undertaken:

- Programmatic and assurance monitoring, including field visits, would be conducted at the end of each quarter.
- Periodic on-site reviews (spot checks) of the implementing partner's financial transactions under direct payment modality would be conducted by an external audit firm three times per year.
- Procurement status reporting, based on the procurement plan, would be undertaken on a quarterly basis.

The audit noted weaknesses in the implementation of the assurance plan as discussed below:

- The Office had only undertaken project monitoring in August 2016 and assurance monitoring at the provincial and municipal levels was not undertaken due to security-related risks. The Office had planned to engage an audit firm to undertake this monitoring. However, as at November 2016, the audit firm was not yet contracted.
- The Office had undertaken only one spot check (during third quarter of 2016) of the implementing partners' transactions.
- Procurement status reporting was not undertaken during the audit period.

The Office's management stated that during the first two quarters of 2016, staff recruitments were still ongoing and programmatic activities were only at the initiation stages. Therefore, spot checks were only carried out in the third quarter of 2016. However, the audit team noted that the Office had already incurred $2.9 million for the Project as of July 2016; therefore, the Office should have undertaken project monitoring of the related activities during the first two quarters. Further, given the fact that the Office had already made payments, it was essential to undertake the spot checks to validate the recorded expenditures of the Project. In response to the draft report, the Office's management stated that staff had undertaken programmatic spot checks regularly.

The OAI audit of the predecessor project ASGP (OAI audit report no. 1408) had also identified weaknesses in monitoring project activities (issue 4).

Inadequate project monitoring increased the risk of not achieving the Project's target and resources not being used for their intended purposes.

Priority	High (Critical)
Recommendation 2: The Office should enhance controls over project assurance by: (a) hiring the audit firm at the earliest to undertake monitoring at the provinces and municipalities; and (b) undertaking regular monitoring and spot checks as per the project assurance plan at the central and provincial levels.	
Management action plan: The Office will contract an external firm to conduct the financial and operational spot checks. **Estimated completion date:** June 2017	

Issue 3 Delays in achieving project implementation targets

The 'UNDP Programme and Operations Policies and Procedures' require offices to prepare Annual Work Plans with specific and realistic targets as well as the activities to be delivered during the year for the achievement of these targets.

As at November 2016, the Project's total financial expenditure was $4.5 million, or 37 percent against the overall budget in Atlas (enterprise resource planning system of UNDP) of $12.3 million. The Office explained that several factors contributed to the low level of expenditure, including:

- Delays in the finalization of National Technical Advisors (NTA) and support staff exit strategy due to extensive negotiations with the implementing partner and donors. An agreement with the implementing partner was reached only in September 2016. As a result, donor funding in 2016 totalling $6.5 million was withheld pending the completion and approval of the baseline survey and the NTA exit strategy.

- Delays in the finalization of the Project's results and resources framework due to delays in the completion of the baseline survey process that was finalized in August 2016.

- Delays in the recruitment of staff as a result of the decision to recruit all of the posts competitively instead of transferring staff from the predecessor project to the new project.

- Discussions leading to the contracting of the third-party entity to implement the project activities at the sub-regional level were also prolonged. The Office signed the contract with the third-party entity at the end of August 2016.

- Delays in the preparation of the Project's budget under UNDP format.

While some of the factors could be considered as being beyond the control of the Office, other factors such as the delays in the preparation of the Project's budget under the UNDP format, recruitment of staff and regional outsourcing, and finalization of the project results and resources framework were well within the control of the Office. Further, the Project was not really a new project but a successor to ASGP, which had faced similar challenges in the past.

Although the Office was aware of the low level of expenditure, the Annual Work Plan budget was not revised to reflect more realistic targets given the delays.

The low financial expenditure of the Project might not be able to contribute to the Office's developmental goals and may negatively impact donor relations.

Priority	Medium (Important)
Recommendation 3: The Office should establish procedures to address delays in project implementation, including: (a) ensuring conditions set with the donors are met in a timely manner; (b) ensuring activities and targets in the Annual Work Plan are realistic and the Project's budget follows the UNDP format; and (c) making timely budget revisions as required.	
Management action plan: The Office accepted the recommendation. **Estimated completion date:** June 2017	

Issue 4 Delayed project progress reporting

According to the 'UNDP Programme and Operations Policies and Procedures', project progress reports should be submitted to the partners within 30 days after the end of each quarter.

The audit team noted delays in the submission of project progress reports, as the 1st and 2nd quarter reports for 2016 were submitted on 26 June and 6 October 2016, respectively, reflecting a delay of two months. As of the date of the audit, the 3rd quarter report was still in draft form. The donors had raised concerns on the delays in progress reporting during discussions with the audit team on 30 October 2016.

The Office stated that the delays were due to the Project not submitting the draft report within the 10-day agreed timeline and the quality of the report submitted required significant revisions. Further, as the Office had not yet recruited a Monitoring and Evaluation Specialist, the task of drafting the progress report fell on the Monitoring and Evaluation Associate who did not have the required skills to draft the progress report.

The Office indicated that an agreement had been reached with donors to revise the report format to mainly focus on key output-related achievements and financial information.

Delayed reporting may jeopardize the timely release of additional funding by donors and may negatively affect the image of UNDP.

Priority	Medium (Important)
Recommendation 4: The Office should accelerate the recruitment of the Monitoring and Evaluation Specialist, streamline the reporting format, and ensure the timely submission of progress reports to donors.	
Management action plan: The recruitment of the Monitoring and Evaluation Specialist was already completed and will be onboard during the first week of January 2017. For the reporting, a simplified format to reduce delays has been agreed. **Estimated completion date:** April 2017	
OAI response: OAI acknowledges the actions taken by management; these will be reviewed at a later stage as part of the standard desk follow-up process of OAI.	

C. Operations

1. Finance

Issue 5 Delays in recovery of costs for services provided to the Project

The 'UNDP Programme and Operations Policies and Procedures' state that direct project costs are organizational costs incurred in the implementation of a development activity or service that can be directly traced and attributed to that development activity or service. With respect to development activities, direct project costs are used to recover the costs of activities that fall under the following two harmonized cost classification categories: programme activities and development effectiveness activities.

The Letter of Agreement between the implementing partner and the Office indicated that the Office provides human resources, finance and procurement services to the Project and recovers the associated costs of services on a quarterly or semi-annually basis.

The Office had been providing these support services to the Project since the inception of its predecessor in October 2015. The Office's management indicated that the costs related to support services provided in 2015 had been recovered. For the first quarter of 2016, the Office had shared the support service costs to be recovered but the Project Manager had not provided the relevant chart of accounts. For support service costs in the succeeding months of 2016, the Office was still in the process of billing all development projects. A similar issue was also included in the audit of the Financial Management and Oversight Unit of the Office (OAI Audit Report No. 1731, Recommendation No. 3).

The Office stated that the delay was mainly due to the time taken to comprehensively understand the direct project cost guidelines and confusion on the types of services to be cost recovered. The Office also completed a workload survey of programme staff and their related direct project costs were included in the Project's 2016 Annual Work Plan. The Office used the corporate guideline of charging at least 40 percent of programme staff time as direct project costs. However, these direct project costs had not yet been recovered, partly due to the resistance of donors to accept such charges. The Office agreed and established a time frame with the Project Manager to ensure the timely recovery of the support service costs.

In addition, the recovery of support service costs in 2015 included costs for services provided to ASGP, resulting in overcharging of approximately $63,000. The Office indicated that it was aware of this mistake and would make the necessary adjustments during the financial closure of ASGP.

Failure to fully recover support service costs may deprive the Office of financial resources, which could negatively affect its ability to achieve intended results.

Priority	Medium (Important)
Recommendation 5: The Office should enhance controls over the recovery of costs from the Project, by: (a) recovering the cost of support services provided for the Project activities; (b) implementing the Direct Project Costing guidelines; and (c) correcting the amount charged to the Project relating to the support services provided to ASGP.	
Management action plan: The Office accepted the recommendation. **Estimated completion date:** December 2016	

Issue 6 Inadequate management of project cash advances

A project cash advance is a one-time advance issued to a custodian for a specific one-time project activity that takes place in remote locations. The 'UNDP Programme and Operations Policies and Procedures' require these project cash advances to be cleared within 7 days after the last day of the project activity, although in the case of the Office, UNDP's Treasury extended the deadline to 14 days. A project 'cash custodian appointment form' must be completed and signed by personnel receiving advances.

The Office provided 13 project cash advances amounting to $93,000 between 1 October 2015 and 30 September 2016. The audit team reviewed a sample of seven project cash advances amounting to $61,000 given to personnel to carry out various project activities together with their corresponding clearances and noted the following exceptions:

(i) There were delays ranging from 7 to 13 days in clearing four project cash advances amounting to $40,000. The Office explained that these delays were mainly because the project cash advances were mostly issued to one staff only, and the project activities were conducted in several regions and they had to wait until the completion of project activities in all regions before processing clearance vouchers. As the Office was already allowed extended timelines of 14 days it should have ensured that the advances were cleared timely.

(ii) During the audit period, two of the three fixed-term appointment staff did not sign the 'cash custodian appointment form' to acknowledge that they were aware of their responsibilities of handling the cash entrusted to them.

(iii) One fixed-term appointment did not comply with the requirements in the 'cash custodian appointment form' not to transfer or sub-delegate the responsibility when he passed on the cash advance received to service contract holders, who in turn carried the cash to the regions.

(iv) Due to security constraints, UNDP staff could not travel to some provinces to deliver the cash. In such cases, the Office paid the vendors through NTAs, who were not UNDP staff and who were working for the Government. This process was against UNDP policies and procedures.

Inadequate controls in managing project cash advances may result in financial losses for UNDP.

Priority	Medium (Important)
Recommendation 6: The Office should ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on the management of project cash advances. This should include: (a) requiring all recipients of project cash advances to sign the 'cash custodian appointment forms' to ensure accountability and to liquidate the cash advances within the required timeframe; (b) ensuring that advances are only retained by the UNDP staff members who have signed the 'cash custodian appointment form' and received the cash advance; and (c) exploring, through consultation with the Office of Financial Resources Management, alternative options for cash advances when UNDP staff cannot travel due to security concerns.	
Management action plan: 'Cash custodian appointment forms' are now being signed by all recipients of project cash advances. The Office will ensure compliance with the 'UNDP Programme and Operations Policies and Procedures'. **Estimated completion date:** June 2017	

2. Human Resources

Issue 7 Mandatory training courses not completed

According to the 'UNDP Programme and Operations Policies and Procedures', all UNDP personnel are required to complete a series of mandatory training courses. These courses include the following: Basic Security in the Field; Advanced Security in the Field; UNDP Legal Framework; Ethics and Integrity at UNDP; Gender Journey; Prevention of Harassment, Sexual Harassment and Abuse of Authority; and UN Human Rights and

Responsibilities. The Basic and Advanced Security in the Field course certificates are valid for three years, at which point staff must recertify.

As at 30 October 2016, only 10 of the 23 staff (43 percent) had completed all 7 mandatory courses. Furthermore, as at 30 October 2016, six staff had Basic Security or Advance Security in the Field course certificates that were expired.

The Office indicated that the mandatory training courses were not completed due to competing tasks.

Failure to complete the mandatory trainings may impact staff knowledge and the capacity to deal with programmatic and operations issues within the Office.

Priority	Medium (Important)
Recommendation 7: The Office should ensure the timely completion of mandatory courses in compliance with the 'UNDP Programme and Operations Policies and Procedures'.	
Management action plan: The Office accepted the recommendation. **Estimated completion date:** March 2017	

3. Assets

Issue 8 Costs for use and transfer of project vehicles not recovered

As at 30 July 2016, the Project had 19 vehicles with a purchase value of $2.9 million. The audit noted the following two issues in the management of the Project's vehicles:

(a) Costs of vehicles used by other projects and Office not recovered

The 'UNDP Programme and Operations Policies and Procedures' state that project vehicles are provided for purposes related to project activities. They also state that costs for services provided to other projects or offices must be fully recovered.

Of the 19 vehicles, 7 with a purchase (or acquisition) value of $0.9 million were located at Regional Offices and had been used by the regional teams from other projects and the Office as part of pooled resources. The Office indicated that no cost recovery had been made regarding the use of vehicles at the Regional Offices as all of the projects and the Office used the resources equally. However, there were no staff of the Project working in the Regional Offices. In August 2016, ownership of three of the seven vehicles was transferred from the Project to the Office.

(b) Costs of project vehicles transferred to the Office not recovered

The 'UNDP Programme and Operations Policies and Procedures' require that all internal transfers of assets be accompanied by an equal transfer of resources equivalent to the net book value of the assets transferred. A transfer of assets with no resources transfer applies under exceptional circumstances where a central unit or a Regional Office purchases items for a group of offices.

The Office transferred from the Project nine armored vehicles (including the three vehicles mentioned under (a) in excess of the Project's operational requirements with a total net book value of $0.4 million in August 2016 with zero transfer cost. There was no written justification found for the zero cost transfer. The Office explained that the transferred vehicles were considered excess for the Project and were no longer needed. Further, these vehicles were purchased during 2008 and 2009, and had minimal re-sale value at the time of transfer.

Failure to recover the costs related to the vehicles utilized by the Office and projects and those transferred may have an impact on the funds available for the Project.

Priority	High (Critical)
Recommendation 8: The Office should ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on cost recovery relating to the use and transfer of project vehicles. This should include: (a) recovering the associated costs of using the seven vehicles until August 2016 and considering transferring the ownership of the remaining four vehicles in the regions to the Office; and (b) reimbursing the Project for the net book value of the nine vehicles as appropriate.	
Management action plan: The Office will ensure necessary adjustments for the 2016 accounts. **Estimated completion date:** December 2016	

Definitions of audit terms - ratings and priorities

A. AUDIT RATINGS

- **Satisfactory** Internal controls, governance and risk management processes were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.

- **Partially Satisfactory** Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.

- **Unsatisfactory** Internal controls, governance and risk management processes were either not established or not functioning well. The issues were such that the achievement of the overall objectives of the audited entity could be seriously compromised.

B. PRIORITIES OF AUDIT RECOMMENDATIONS

- **High (Critical)** Prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP.

- **Medium (Important)** Action is required to ensure that UNDP is not exposed to risks that are considered moderate. Failure to take action could contribute to negative consequences for UNDP.

- **Low** Action is desirable and should result in enhanced control or better value for money. Low priority recommendations, if any, are dealt with by the audit team directly with the Office management, either during the exit meeting or through a separate memo subsequent to the fieldwork. Therefore, low priority recommendations are <u>not included in this report</u>.