UNITED NATIONS DEVELOPMENT PROGRAMME
Office of Audit and Investigations

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AUDIT

OF

UNDP AFGHANISTAN

AFGHANISTAN SUB-NATIONAL GOVERNANCE PROGRAMME

(Directly Implemented Project No. 58922)

Report No. 1062

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Report on the audit of UNDP Afghanistan
Sub-national Governance Programme
Executive Summary

From 29 June to 14 August 2012, the Office of Audit and Investigations (OAI) of the United Nations Development Programme (UNDP) conducted an audit of the Afghanistan Sub-national Governance Programme (Project No. 58922) (the Project) which is directly implemented and managed by the UNDP Country Office in Afghanistan (the Office). The audit covered the activities of the Project during the period from 1 January 2011 to 31 March 2012. During the period reviewed, the Project recorded programme and management expenditures totalling $12 million. The following donors contributed to the Project: European Union, UNDP, United Kingdom, Switzerland, Italy and Australia.

The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. These Standards require that OAI plan and perform the audit to obtain reasonable assurance on the adequacy and effectiveness of the governance, risk management, and control processes. The audit includes reviewing and analysing, on a test basis, information that provides the basis for the conclusions and audit results.

Audit rating

OAI assessed the Project as **unsatisfactory**, which means "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." This rating was due to serious concerns regarding project and operations management. Ratings per audit area and sub-areas are summarized below.

Audit Areas	Not Assessed/ Not Applicable	Unsatisfactory	Partially Satisfactory	Satisfactory
1. Organization and staffing			Partially Satisfactory	
2. Project management		Unsatisfactory		
3. Operations			Partially Satisfactory	

3.1 Human resources	Satisfactory
3.2 Financial and cash management	Unsatisfactory
3.3 Procurement	Not Assessed
3.4 Asset management	Unsatisfactory
3.5 Information systems	Satisfactory
3.6 General administration	Satisfactory
3.7 Follow-up on previous audits	Not Applicable

Key issues and recommendations

The audit raised eight issues and resulted in seven recommendations, all of which were ranked high (critical) priority, meaning "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 and may affect the organization at the global level."

Several of the high priority recommendations are presented below:

Project management (Issue 2)	Inadequate Project governance. Only one Project Board meeting was held during the audit period, although the Board was required to meet quarterly. Board approvals were thus not obtained for major programmatic decisions. Funding for planned activities was inadequate and key monitoring and evaluation functions were not implemented. A comprehensive exit strategy was lacking and progress reporting was unclear. OAI recommends that the Office comply with the Programme and Operations Policies and Procedures by strengthening its governance processes and by: (a) establishing a resource mobilization strategy which considers the changes in donors' focus and the in-country situation; (b) ensuring that progress reports include a comparison of actual progress against planned outputs and that the Annual Work Plans include clear and quantifiable benchmarks and targets; and (c) developing a comprehensive exit strategy to ensure sustainability of activities.
(Issue 3)	Poor management of Letters of Agreement. The Office did not comply with provisions of the Letters of Agreement signed with the government counterparts. For example, the Office did not conform with Letter of Agreement provisions regarding participation in personnel performance assessments, conducting capacity assessments prior to releasing advances to government counterparts and finalizing guidelines for the proper utilization of funds by counterparts. Furthermore, the standard operating procedures, which included guidelines for properly utilizing funds and the recruitment process, had not been finalized. OAI recommends that the Office improve the management of Letters of Agreement by: (a) identifying the deficiencies in the management arrangements, coordination and oversight mechanisms and in collaboration with project management, Independent Directorate of Local Governance (IDLG), Provincial Governor Offices and the municipalities, amend the Letters of Agreement as appropriate, to address the deficiencies and clarify roles and responsibilities, including the ownership and maintenance of bank accounts; (b) ensuring that the IDLG avoids cash transactions and makes payments by cheque only, and that formal receipts or other adequate supporting evidence are required from the vendors to confirm receipt of payments for goods and services delivered; and (c) finalizing the standard operating procedures to address areas such as the utilization of funds and recruitment, and conducting adequate monitoring and ensure strict compliance with them.
(Issue 4)	Weak oversight over compliance with Letter of Agreement. Even though the Project had paid $3.7 million in salaries, it did not have accurate records of eligible personnel to be paid under the contracts with the government institution, nor had it established a standard salary scale or reviewed timesheets before authorizing salary payments to Project personnel. Some personnel inappropriately received salaries from both UNDP and the government. OAI recommends that the Office implement adequate controls to ensure compliance with the Letter of Agreement relating to the personnel recruited and contracted by the responsible party and the payment of their salaries by: (a) establishing an accurate list of personnel under contract with the government institution and eligible to be paid; (b) establishing a salary scale for such personnel; (c) conducting an independent review of monthly payrolls, timesheets, and activity reports; and (d) developing an action plan to identify those personnel who were inappropriately receiving salaries from two sources, halt such payments and recover amounts incorrectly paid.

Financial and cash management (Issue 6)	Significant weaknesses in managing Project advances. The Office released advances to Provincial Governor Offices totalling $3.3 million, of which $0.9 million remained outstanding as of July 2012. OAI recommends that the Office ensure compliance with the Programme and Operations Policies and Procedures on the use of cash advances by making arrangements with the Provincial Governor Offices and municipalities for the timely liquidation of outstanding advances.

Management comments and action plan

The Country Director accepted all recommendations and is in the process of implementing them.

Helge S. Osttveiten
Director
Office of Audit and Investigations

I. Introduction

From 29 June to 14 August 2012, the Office of Audit and Investigations (OAI) conducted an audit of the Afghanistan Sub-national Governance Programme (Project No. 58922) (the Project), which is directly implemented and managed by UNDP Afghanistan (the Office). The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. These Standards require that OAI plan and perform the audit to obtain reasonable assurance on the adequacy and effectiveness of governance, risk management, and control processes. The audit includes reviewing and analysing, on a test basis, information that provides the basis for the conclusions and audit results.

Audit scope and objectives

OAI audits assess the adequacy and effectiveness of the governance, risk management, and control processes in order to provide reasonable assurance to the Administrator regarding the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and compliance with legislative mandates, regulations and rules, policies and procedures. The audits also aimed to assist the management of the Office and other relevant business units in continuously improving governance, risk management, and control processes.

Specifically, this audit reviewed the following areas of the Project: organization and staffing, programme activities, and operations. The audit covered relevant activities during the period from 1 January 2011 to 31 March 2012. During the period reviewed, the Project recorded programme and management expenditures totalling $12 million.

II. About the Project

The Project is a multi-donor programme assisting the Government of Afghanistan (the Country) since 2006. The Independent Directorate of Local Governance (IDLG) is the main government partner responsible for building the institutional structures and capacity required for effective service delivery. Phase I of the Project (2006-2010) introduced significant reforms in governance at the provincial, district, and municipal levels. The Phase II Project Documents confirmed that the Project had increased the capacity of several IDLG units, namely, the Policy Unit, the Finance and Administration Department, the Directorate for Municipal Affairs, the Afghanistan Stabilization Programme, the Provincial Council Relations and Cooperation Directorate, the Audit Unit, the Capacity Building Unit and the Information Technology Unit.

Phase II of the Project (2010-2014) required $180 million in total resources. The overall Project objective was to support two outcomes of the United Nations Development Assistance Framework, namely, Outcome 2, "Government capacity to deliver services to the poor and vulnerable is enhanced" and Outcome 3, "The institutions of democratic governance are integrated components of the nations."

III. Detailed assessment

1. Organization and staffing — Partially Satisfactory

The Office and the Project operate in an unstable, conflict environment in the Country. The Office continues to face various challenges, such as recruitment of experienced staff, absence of a well-developed commercial market place, high security risks and the absence of well-developed financial institutions. These factors have resulted in a complex operating environment with a high risk of misuse of funds, fraud and misappropriation. It is therefore critical to ensure that there is good governance for effective utilization of Project resources. In assessing the current situation, OAI took into account the prior year's audit of the Project (Report No. 905, 21 August 2012), which resulted in an overall "unsatisfactory" rating due to weaknesses in the areas of organization and staffing, project management, finance and asset management.

The Office hired a number of personnel under different contract modalities as follows: 6 international professionals, 62 service contract holders and 2 individual contractors. OAI reviewed the organizational structure and staffing, including the Human Resources Plan for 2011-2012. The Project had been experiencing an acute staff shortage. Its approved 2011 Human Resources Plan listed 119 positions, of which 74 were vacant, while the 2012 Human Resources Plan as of July 2012 (at the time of the audit) listed 112 positions, of which 39 were vacant.

The September 2011 Independent Evaluation and Review raised concerns about the Office's micro-management of the Project and its centralized decision-making. The Office informed OAI that management of the Project had improved since the arrival of the Chief Technical Advisor in September 2011, although the staffing shortage remained unresolved.

Due to the high priority issue noted below, which has been persistent, this area was assessed as "partially satisfactory."

Issue 1 Staffing requirements not met

In March 2012, OAI conducted an audit of the Office's human resources management, which identified several issues, including positions remaining vacant for long periods (Report No. 974, 5 September 2012). The audit report specifically mentioned that the Project's management positions had been vacant from 2010 to 2012.

Project management informed OAI that the staffing shortage was a major contributing factor in not meeting its target delivery in 2011. In this regard, the Project had only expended $12.7 million of its approved budget of $33.9 million, resulting in 37 percent delivery. In the view of OAI view, the Project's delivery might not have improved in 2012, as the final Annual Work Plan and Human Resources Plan were only approved at the end of July 2012. According to the UNDP Executive Snapshot, the Project had only expended 23 percent of its $23 million budget as of August 2012. Although the Office indicated that vacancy announcements had been initiated, there was no assurance that candidates would be successfully recruited in a timely manner. Project management also explained that the monitoring and oversight functions had not been adequately performed due to staff shortages (please refer to Issues 2 and 3 for additional details).

The positions had not been filled mainly due to inadequate planning and delays in recruitment at the Office level. Further, the in-country security situation made it difficult to attract suitable candidates. The risk of not being able to implement planned activities and achieve intended outputs remained high if the staffing vacancies continued.

Priority	High (Critical)
Recommendation 1: The Office should assess the progress made in recruitment and prepare an action plan to identify ways of addressing the remaining staffing gaps in order to mitigate the risk of failing to achieve its target delivery.	
Management comments and action plan: __√__ Agreed ____ Disagreed The Office stated that: (a) most of the vacant positions were filled and Project delivery increased as of 31 December 2012; (b) the Human Resources Plan for 2013 was prepared and the Office had already started the recruitment process for the remaining vacancies; and (c) Project delivery would be monitored on a monthly basis.	

2. Project management — Unsatisfactory

OAI reviewed the Project Document, Annual Work Plans, Letters of Agreement with government counterparts, quarterly and annual progress reports, and interviewed Office and Project personnel.

In November 2010, the Office signed a Central Letter of Agreement with IDLG to support its key directorates responsible for developing and implementing strategies and policies. In February 2011, the Office signed 34 Provincial Letters of Agreement with Provincial Governor Offices to empower these offices financially and programmatically to promote effective governance at the sub-national level. According to Project management, these Letters of Agreement replaced the "Task Orders" modality that was used during Phase I of the Project.[1] Letters of Agreement are meant to establish the conditions, expectations, and responsibilities when a government institution is to cooperate with UNDP and carry out activities as a responsible party on a project that is directly implemented by UNDP. A responsible party is directly accountable to the implementing partner in accordance with the terms of the agreement or contract with the implementing partner.

Considering the material control weaknesses noted below, this area was assessed as "unsatisfactory."

Issue 2 <u>Inadequate Project governance</u>

The Programme and Operations Policies and Procedures require the Office to conduct monitoring and oversight of the Project to ensure that it is: (a) making progress towards intended outputs; (b) mobilizing and utilizing resources appropriately; (c) supporting national ownership and ongoing stakeholder engagement and sustainability; and (d) ensuring outputs contribute to intended programme outcomes. Such monitoring and oversight are among the most important responsibilities of the Project Manager. OAI noted that critical components of Project governance were not established to ensure successful Project implementation and achievement of Project outputs.

[1] As part of the agreement between the Project and IDLG, several "Task Orders" were issued listing the costs of professional positions and equipment to be covered by the Project to support the activities at the Provincial Governor Offices and municipalities.

(a) Project Board meetings not held quarterly

The Project Board is responsible for making Project management decisions, including approval of Project plans and revisions. The Project Document required the Board to meet quarterly.

However, the Project Board only met twice between January 2011 and June 2012. OAI noted that the Office made several programmatic decisions without obtaining approvals from the Project Board. For example, the decisions to pay the salaries of personnel recruited by IDLG to implement some activities of the Policy Advisory and Development Project and a continued use of the Task Orders had not been approved by the Project Board (Refer to Issue 5 for further details). Further, the Independent Evaluation and Review of the Project questioned the validity of the Letters of Agreement with IDLG and Provincial Governor Offices as they were not approved by the Project Board. The Project did not explain why the Project Board had not met as required, but stated that regular meetings would be held in the future.

(b) Inadequate funding to support Project activities

According to the Project Document, $180 million was required to implement Phase II of the Project. However, at the time of the audit, only $46 million had been mobilized, leaving $134 million or about 74 percent of the required $180 million unfunded. This lack of funding was due to factors such as a change in donor focus and the existing in-country situation. Subsequent to the audit fieldwork, Project management informed OAI that new donors had made commitments which would ensure financial support beyond 2012. However, there was no clear indication that these commitments would fully cover the funding gap, which remained high. As of September 2012, the resources mobilized totalled $60.8 million.

(c) Unclear reporting of Project outputs

The Independent Evaluation and Review of the Project reported that the Office had not clearly articulated the results achieved and the relevance of the activities undertaken to meet its intended results. The 2011 progress report did not specifically report the actual progress made against planned outputs in the Annual Work Plan. For example, the 2011 Annual Work Plan had listed three activities under Component II, “Support to Municipality” and established a total of 31 benchmarks and targets relating to these components. However, the Annual Progress Report did not identify the progress made towards achieving 25 of the 31 targets and failed to provide adequate information on the reported progress of the other six targets. Further, the Annual Work Plan did not include clear or quantifiable benchmarks and targets for three of four components/outputs. As such, it was difficult to assess how the Office calculated the delivery rates in the Annual Progress Report.

(d) Several monitoring and evaluation activities had not been implemented

Several activities were planned to strengthen the Project's monitoring and evaluation function (as outlined in the Project Document). These included: (a) establishing a central monitoring and evaluation and Knowledge Management Unit and monitoring and evaluation offices in the Provincial Governor Offices; (b) conducting regular Project site assurance visits by the Office’s Local Governance Team to monitor the quality of programme activities; and (c) completing annual Project reviews during the first quarter of the following year. However, none of these activities were carried out due to staffing issues.

(e) Absence of an exit strategy

According to the Programme and Operations Policies and Procedures, each project should develop and implement plans to ensure the development of capacity as well as an exit strategy to leave behind sustainable and resilient entities. Although the Office had established plans for developing the capacity of IDLG, it had not developed a comprehensive exit strategy with targets and milestones.

In March 2012, IDLG drafted a strategy that allowed for transitioning and positioning it into the World Bank-supported government-wide National Technical Assistance program. According to Office management, this "bridging" arrangement would serve as a model for the Project's exit strategy. Also, a Financial Planning Advisor was being recruited to work with the Office and IDLG on the bridging arrangement. However, it was not clear if the Advisor's terms of reference would also include development of a comprehensive exit strategy.

The lack of adequate Project governance could lead to the loss of donor interest and adversely affect the competitive advantage of UNDP over other development organizations.

Priority	High (Critical)
Recommendation 2: The Office should comply with the Programme and Operations Policies and Procedures by strengthening its governance processes and by: (a) establishing a resource mobilization strategy which considers the changes in donors' focus and the in-country situation; (b) ensuring that progress reports include a comparison of actual progress against planned outputs and that the Annual Work Plans include clear and quantifiable benchmarks and targets; and (c) developing a comprehensive exit strategy to ensure sustainability of activities.	
Management comments and action plan: __√__ Agreed ____ Disagreed The Office stated that it is working on developing a resource mobilization strategy and will ensure that quarterly and year-end progress reports contain comparisons between the Project objectives and the progress made toward achieving them. The Office also agreed to develop an exit strategy by 31 December 2013, or one year before the Project end-date. Further, project management indicated that it will ensure compliance during the project implementation, including holding quarterly Project Board meetings in 2013.	

Issue 3 <u>Poor management of Letters of Agreement</u>

The signed Letters of Agreement outlined the responsibilities of the Office, IDLG, and Provincial Governor Offices, which included opening and operating Project bank accounts, making Project cash advances, and recruiting personnel and appraising their performance. OAI reviewed the related supporting documents, and noted deficiencies in Letter of Agreement management arrangements as described below.

(a) Central Letter of Agreement with IDLG

This Letter of Agreement required opening a Project bank account in the local currency to transfer cash advances to IDLG for use in implementing Project activities. However, a bank account in US currency was opened instead. Since most of the vendors required payments in local currency, IDLG issued cheques in US currency to its personnel, who cashed the cheques and converted the US dollar amounts into local currency and then made cash payments to the vendors. The Project exercised little or no oversight over such cash payments made by IDLG personnel. Furthermore, there were no official receipts or other evidence that the vendors had received the payments. Project personnel explained that most vendors did not have official receipts and that they only stamped the invoices confirming receipt of payments. OAI noted that the stamps showed the name of the business or vendor but did not actually indicate that payments had been received. There was also no evidence showing that controls had been established to reduce the risk of fraud or misappropriation of funds. Hence, OAI could not determine the validity of these expenditures.

The Letter of Agreement required opening six provincial bank accounts, initially. However, the Office facilitated the opening of 29 bank accounts after signing the Provincial Letters of Agreement. Project management explained that opening these accounts had been arranged in coordination with the Provincial Governor Offices as part of the plan to strengthen capacity at the sub-national level. However, IDLG was not consulted on this matter as required, which created differences between the Office and IDLG and negatively impacted the overall implementation of Project activities.

The Letter of Agreement required the Office and IDLG to jointly manage the recruitment of personnel, including appraising their performance every six months. Although the Project staff participated in the recruitment function, they were not involved in the personnel assessments. The Office informed OAI that IDLG was responsible for hiring and appraising personnel while the Project was responsible for reviewing the process as part of its oversight functions. However, it did not explain why the Letter of Agreement was not amended to reflect the actual responsibilities. In the view of OAI, the Office's involvement in personnel assessments could have avoided many of the issues noted in the oversight of compliance relating to personnel discussed in Issue 4 below.

(b) Provincial Letters of Agreement with Provincial Governor Offices

The Letters of Agreement referred to Attachment 3, "Schedule of Activities and Payments," but this Schedule was not attached. According to the Office, the Schedule was not available at the time the Letters of Agreement were signed. As a result, it was not clear what specific activities and budgeted costs were agreed to be delivered by IDLG and funded by the Office.

The Letters of Agreement outlined the IDLG roles in the Provincial Letters of Agreement, such as requesting assistance from the Office in opening provincial bank accounts and endorsing the provincial workplans, budgets and quarterly action plans. Furthermore, no decision was to be made between the Office and Provincial Governor Offices without close consultation with IDLG. However, the Office had made direct arrangements with the Provincial Governor Offices. As mentioned above, this created differences between the Office and IDLG which had negatively impacted the Project activities.

The Letters of Agreement required the Office to make cash transfers to the "project account in Afghani (local) currency" to carry out sub-national level activities. Aside from facilitating the opening of 29 bank accounts for the Provincial Governor Offices, 11 bank accounts in US currency were also opened for municipalities. However, the signed Letters of Agreement with the Provincial Governor Offices did not require establishing separate bank accounts and transferring funds to municipalities.

The standard operating procedures, which included guidelines for the proper utilization of funds and the recruitment process, had not been finalized and shared with the responsible parties. Project management advised that the draft standard operating procedures were shared with IDLG in 2011 when the first advance was released. According to the IDLG officials interviewed, the delay in liquidating the advances was mainly due to the absence of clear guidance or procedures for properly utilizing the funds and preparing the financial reports.

According to Project management, the above shortcomings were mainly due to a severe staff shortage. In order to improve management of Letters of Agreement, the Project indicated that the Letters were being amended to include preparation of risk-mitigation plans.

Due to inadequate management of the Letters of Agreement , there is no assurance that intended outputs will be achieved and resources utilized properly.

Priority	High (Critical)
Recommendation 3: The Office should improve the management of Letters of Agreement by: (a) identifying the deficiencies in the management arrangements, coordination and oversight mechanisms and in collaboration with Project management, IDLG, Provincial Governor Offices, and the municipalities, amend the Letters of Agreement as appropriate, address the deficiencies and clarify roles and responsibilities, including the ownership and maintenance of bank accounts; (b) ensuring that the Independent Directorate of Local Governance avoids cash transactions and makes payments by cheque only, and that formal receipts or other adequate supporting evidence are required from the vendors to confirm receipt of payments for goods and services delivered; and (c) finalizing the standard operating procedures to address areas such as the utilization of funds and recruitment, and conducting adequate monitoring and ensure strict compliance with them.	
Management comments and action plan: __√__ Agreed ____ Disagreed The Office stated that the banks were advised that the ownership of bank accounts lies with the respective account holder and also that transfers to government counterparts is now made in local currency only. Further, it is in the process of hiring a firm to perform the capacity assessment of its government partners. The Project also finalized the comprehensive standard operating procedures and training sessions were held in the regional offices. Further, the Project indicated that it hired a consultant to strengthen the Project monitoring and oversight of the Letters of Agreement.	

Issue 4 Weak oversight over compliance with Letter of Agreement

Additionally, IDLG recruited about 300 personnel under the signed Letter of Agreement to implement Project activities. These personnel were to be recruited on a contract with IDLG. The Project staff and government counterparts jointly managed the recruitment of personnel under the Letter of Agreement and followed the government's hiring procedures. The Letter of Agreement provided that the Office would endorse all positions financed under it and the Office and IDLG would jointly appraise the performance of these personnel. During the audit period, the Project paid approximately $3.7 million for personnel salaries recruited under the Letter of Agreement.

In September 2011, the Independent Evaluation and Review of the Project identified a lack of controls for tracking recruitments, budgets, and actual expenditures, including salaries of personnel hired on IDLG contracts. Due to the lack of controls, there was no assurance that salaries had been paid to eligible personnel. The Project responded that the relevant standard operating procedures, which would address these control issues, were being prepared.

However, OAI noted that control weaknesses persisted. The Project had not established adequate controls over the payment of personnel salaries totalling $3.7 million, as discussed below:

(a) The Project was unable to provide a complete listing and accurate records of all eligible personnel under contract with IDLG. During the audit fieldwork, the Project provided OAI with differing lists of such personnel.

(b) It was not clear how Project management determined the accuracy of the salary rates paid. Furthermore, some personnel salaries were increased significantly during the audit period, which according to IDLG, was due to changes in personnel positions. However, Project management had not performed due diligence to ensure that salary increases were justified and in accordance with the Letter of Agreement.

(c) Project management had not conducted an independent review of monthly payrolls, timesheets, and activity reports of the personnel recruited under the Letter of Agreement and only relied on IDLG confirmation, which included certifying that personnel were not receiving salaries from other sources. However, 4 of 60 personnel interviewed indicated that they were receiving salaries both from IDLG and UNDP. Project management was unable to provide the list of personnel receiving salaries from both entities, which OAI had requested, and failed to explain the rationale for this arrangement.

Delayed implementation of adequate control mechanisms increases the risk of making unauthorized or incorrect salary payments.

Priority	High (Critical)
Recommendation 4: The Office should implement adequate controls to ensure compliance with the Letter of Agreement relating to the personnel recruited and contracted by the responsible party and the payment of their salaries by: (a) establishing an accurate list of personnel under contract with the government institution and eligible to be paid; (b) establishing a salary scale for such personnel; (c) conducting an independent review of monthly payrolls, timesheets, and activity reports; and (d) developing an action plan to identify those personnel who were inappropriately receiving salaries from two sources, halt such payments and recover amounts incorrectly paid.	
Management comments and action plan: __√__ Agreed ____ Disagreed The Office indicated that the established standard operating procedures clearly stipulate the Office's oversight role over the recruitment and performance evaluation of the personnel under the Letter of Agreement. The Office will ensure review/verification of the documents associated with salaries and other Project expenditures. They will also request that all personnel sign disclosure letters on whether they are receiving salaries from any other sources and will take action to recover amounts incorrectly paid.	

3. Operations — Partially Satisfactory

3.1 Human resources — Satisfactory

Since OAI recently conducted an audit of the Office's overall human resources management, which included the Project (Report No. 974 issued on 5 September 2012), the review of this area of the audit focused on the management of the Project's service contract holders and personnel recruited under Letters of Agreement.

The Office managed the recruitment of personnel centrally while the Project prepared the Human Resources Plans and participated in reviewing candidate qualifications and interviewing them. OAI reviewed records relating to 13 of the 62 service contract holders and noted inadequate documentation, such as missing approvals by the hiring manager (three cases), missing or unsigned performance evaluations (four cases), and missing personnel files (two cases). The Project agreed to take action to address these issues.

3.2 Financial and cash management — Unsatisfactory

Given the high level of perceived corruption in the Country and the complex operating environment caused by insecurity, it is critical to provide sufficient oversight to ensure efficient and effective utilization of resources. There are high risks associated with making cash payments to personnel, vendors and training conference participants. The risk is compounded when cash payments are made in remote areas of the Country. It is therefore imperative that cash payments are minimized and that mitigating controls are established to adequately control such payments when they are necessary.

During the audit period, the Office processed 1,312 payment vouchers totalling $17.3 million. OAI reviewed 44 payment vouchers totalling $3.4 million. The Project finance personnel were responsible for reviewing requests for Project advances, liquidation of advances and processing direct payments, as well as preparing payment vouchers in Atlas.

Considering the material control weaknesses noted, this area was assessed as "unsatisfactory."

Issue 5 Inadequate controls over salary payments

The UNDP Internal Control Framework requires offices to review the accuracy of the payments and ensure proper supporting documentation before creating payment vouchers. The Project Manager is the first authority responsible for ensuring the validity of transactions. Of the 44 payment vouchers reviewed, 34 pertained to the payment of salaries totalling $2.5 million for the period 1 January through 31 March 2012. OAI noted internal control weaknesses in approving payments through these vouchers.

(a) The processing of 28 payment vouchers totalling $0.9 million was authorized under Task Order Nos. 5, 8, 12, 13 and 21, which had expired. The Project advised OAI that it intended to transfer the accountability for paying personnel salaries to the Provincial Letters of Agreement. However, there had been delays in finalizing the Provincial Letters of Agreement and in releasing funds due to challenges in 2010-2011, such as the difficulties in filling senior-level posts, including the Project Manager position. Since personnel continued to perform their duties, the Project was committed to paying their salaries and to charging them against the Task Orders. Project management reported that personnel salaries were no longer being paid against Task Order Nos. 5, 8, 12 and 13 as of April 2011, but had continued charging salaries against Task Order No. 21. Justification and authority for doing so were not provided.

(b) Three payment vouchers totalling $80,000 covering the first quarter of 2011 were not related to the Project. An email dated 3 March 2011 from the Office indicated that the relevant Letter of Agreement had expired at the end of 2010 and personnel salaries were to be integrated into the Central Letter of Agreement. However, the Letter of Agreement was not revised to reflect this addition. No justification or authority for paying these salaries was provided to OAI.

(c) Three payment vouchers totalling $2 million related to the IDLG liquidation of advances it received for the last three quarters of 2011. The majority of the funds were utilized to pay personnel salaries totalling $1.5 million or 75 percent of the liquidated amount. The signed Central Letter of Agreement required IDLG to submit personnel timesheets and monthly activity reports and Project management was to review and approve them prior to making payment. Although the timesheets and monthly activity reports were prepared, they were retained by IDLG and not submitted to the Project office for review. Project management relied on the IDLG officer's certification and signature affixed to the payroll.

Without implementation of adequate internal controls, the risk of financial losses is increased.

Priority	High (Critical)
Recommendation 5: The Project should comply with UNDP Operational Guidelines of the Internal Control Framework by: (a) obtaining the necessary approval from the Project Board on programmatic decisions; (b) ensuring that the required documentation is provided by responsible parties; (c) implementing processes to ensure that adequate review and due diligence is performed prior to paying personnel salaries.	
Management Comments: __√__ Agreed ____ Disagreed	

Issue 6 Significant weaknesses in managing Project advances

The Programme and Operations Policies and Procedures require projects to closely monitor fund advances to mitigate the risk that funds transferred may not be used as intended. During the audit period, the Office advanced funds totalling $6.4 million to the IDLG, Provincial Governor Offices and municipalities. OAI noted serious weaknesses in the management of these advances, as discussed below.

The Project released advances to the Provincial Governor Offices and municipalities totalling $3.3 million in November and December 2011, of which $0.9 million remained outstanding as of July 2012. Project management informed OAI that the planned Project activities could not be implemented due to a misunderstanding relating to responsibility for managing Project activities that arose between the Office and IDLG. Consequently, IDLG instructed the Provincial Governor Offices and municipalities not to spend the $3.3 million received. The delays in preparing standard operating procedures (refer to Issue 3) also hindered the proper reporting of funds utilization.

Priority	High (Critical)
Recommendation 6: The Office should ensure compliance with the Programme and Operations Policies and Procedures on the use of cash advances by making arrangements with the Provincial Governor Offices and municipalities for the timely liquidation of outstanding advances.	
Management comments and action plan: __√__ Agreed ____ Disagreed The Office stated that it has taken a number of measures to ensure timely liquidation of advances, such as finalizing the standard operating procedures, conducting training, and monitoring of outstanding advances.	

Issue 7 Unclear ownership of Project bank accounts

According to the Programme and Operations Policies and Procedures, bank accounts opened for fund advances and expenses should not be considered UNDP accounts. Furthermore, UNDP should not make arrangements to open such accounts or act as a signatory for them.

In November 2010, the UNDP Treasury agreed with the Office and facilitated the opening of Project bank accounts, but advised the Office to ensure that UNDP assumed no liability for the accounts. The Treasury attached a standard letter clarifying that bank accounts were not owned or managed by UNDP and that UNDP staff would not serve as signatories. In May 2011, the Office facilitated the opening of a bank account in US currency for IDLG. The Office's former Country Director signed the form opening the account and the form authorizing IDLG officials as signatories. OAI noted that accounts in US currency were also opened with the same bank for three more UNDP projects[2] under the same arrangement.

Further, the Project management informed OAI that the Office facilitated the opening of 29 bank accounts for Provincial Governor Offices with another bank, but no account opening forms were signed.

OAI noted that, after the accounts were opened, instructions to the banks about changes in authorized signatories continued to be issued by the Office. In June 2012, the new Country Director advised the bank that the sole responsibility for the accounts rested with the IDLG and the Provincial Governor Offices. The communication added that UNDP would no longer intervene with any nomination or nullification of bank account signatories.

The Office maintained that these accounts were owned by the government counterparts and stressed that its role was only to facilitate the opening of the accounts with clear instructions that the accounts would not be owned or managed by UNDP. However, OAI is of the opinion that until June 2012, the ownership of the bank accounts stayed with the Office because the former Country Director signed the bank account opening forms and the Office continued to communicate changes in authorized bank signatories to the banks. The ownership of these bank accounts by UNDP is contrary to the guidance and instructions communicated by Treasury and could expose UNDP to financial risks.

[2] Afghanistan Peace and Reintegration Programme (opened in December 2010), Agriculture Support for Peace and Reintegration (opened in August 2011), and Institutional Development & Organizational Restructuring Program (opened in February 2012)

OAI sought clarification from the Treasury, which confirmed that the Office's action confused the ownership condition. The Treasury further informed OAI that the bank at which the IDLG account was opened was ceasing operations in Afghanistan. Treasury was working with the Office to transfer the UNDP accounts to another bank. The Office informed OAI that it requested IDLG to open a bank account in local currency and advised that no future advances would be released in US dollars. In view of this, no recommendation has been made.

3.3 Procurement — Not Assessed

The Project was responsible for preparing the procurement plan, raising e-requisitions, and confirming satisfactory receipt of goods and services, while the Office managed the main procurement process. During the audit period, the Office processed 1,112 purchase orders with a total value of $6.3 million for the Project. OAI reviewed a sample of 44 purchase orders totalling $2.2 million or 35 percent of the total.

As OAI planned to conduct a procurement audit of the Office during the fourth quarter of 2012, the audit of the Project's procurement function was limited to reviewing the procurement plan, e-requisitions, receipt of goods and services, and selected the purchase orders mentioned above to develop an understanding of the procurement process.

3.4 Asset management — Unsatisfactory

As of March 2012, the Project's inventory listing included 445 assets valued at $3.6 million, excluding assets procured directly by IDLG. OAI conducted physical verifications of 77 assets valued at $0.9 million, and did not identify any reportable issues. However, the audit showed that the Project did not adequately manage the assets maintained at IDLG.

Due to an unresolved control issue, this area was assessed as "unsatisfactory."

Issue 8 Inadequate management of Project assets

The Programme and Operations Policies and Procedures require that offices regularly verify all assets. Furthermore, the signed Letter of Agreement between UNDP and IDLG requires the latter to maintain assets and equipment procured using UNDP functional and operational resources as part of its inventory. Furthermore, IDLG needed to ensure that these assets were used solely for the Project.

The Project staff conducted a physical verification of its assets, but did not include those assets directly procured by IDLG using UNDP resources. Furthermore, OAI was unable to independently verify these assets because the list was not made available, although during the audit fieldwork the Project staff indicated that they had repeatedly requested that IDLG provide the list. The same situation had occurred when conducting the prior year audit of the Project. As a result, the auditors rendered a disclaimer opinion on the Statement of Assets as of 31 December 2010 due to the non-availability of the asset listing maintained by IDLG.

Project management informed OAI that since the assets were controlled and used by IDLG and not recorded in the Atlas assets module, they believed that no independent verification was necessary. However, the relevant Letter of Agreement provisions clearly state that the Project is required to monitor these assets. By failing to do so, there is no assurance that assets will be safeguarded and used for intended purposes.

Priority	High (Critical)
Recommendation 7: The Office should establish control procedures for managing assets directly procured by the IDLG by: (a) requiring the Directorate to maintain a complete list of such assets and further that it should submit the list to the Project upon request; and (b) conducting independent verifications to ensure the existence and proper use of these assets.	
Management comments and action plan: __√__ Agreed ____Disagreed The Office stated that the standard operating procedures provide clear guidelines on the maintenance of assets purchased under the Letters of Agreement. Also, it is in the process of updating the list of assets maintained by the government partners and plans to conduct physical verification of assets.	

3.5 Information systems — Satisfactory

During the planning stage of this audit, OAI noted that transactions related to human resources, finance and procurement were processed and the critical supporting files were kept at the office. Based on the relevant documents reviewed, OAI assessed this area as low risk and no further fieldwork work was performed.

No other reportable issues were identified.

3.6 General administration — Satisfactory

Based on the review of relevant documents during the audit planning stage, OAI assessed this area as low risk and no further work was performed during the audit fieldwork.

No other reportable issues were identified.

3.7 Follow-up on previous audits — Not Applicable

The Office agreed with all 12 recommendations contained in the prior OAI audit report (Report No. 905) issued on August 2012, and was in the process of implementing them. OAI did not assess the progress made on implementing these audit recommendations, as the prior report was issued after the completion of the fieldwork for this audit.

ANNEX. Definitions of audit terms - Ratings and Priorities

A. AUDIT RATINGS

In providing the auditors' assessment, the Internal Audit Services of UNDP, UNFPA, UNICEF, and WFP use the following harmonized audit rating definitions. UNDP/OAI assesses the country office or audited HQ unit as a whole as well as the specific audit areas within the country office/HQ unit.

- **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. *(While all UNDP offices strive at continuously enhancing their controls, governance and risk management, it is expected that this top rating will only be achieved by a limited number of business units.)*

- **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. *(A partially satisfactory rating describes an overall acceptable situation with a need for improvement in specific areas. It is expected that the majority of business units will fall into this rating category.)*

- **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. *(Given the environment UNDP operates in, it is unavoidable that a small number of business units with serious challenges will fall into this category.)*

B. PRIORITIES OF AUDIT RECOMMENDATIONS

The audit recommendations are categorized according to priority, as a further guide to UNDP management in addressing the issues. The following categories are used:

- **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 and may affect the organization at the global level.

- **Medium (Important)** Action is required to ensure that UNDP is not exposed to significant risks. Failure to take action could result in 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>.