



AUDIT

OF

UNDP AFGHANISTAN

MAKING BUDGET AND AID WORK
(Directly Implemented Project Nos. 56407 and 74281)

Report No. 1103
Issue Date: 17 May 2013

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Report on the audit of UNDP Afghanistan Making Budget and Aid Work Project Executive Summary

From 30 June to 14 August 2012, the Office of Audit and Investigations (OAI) of the United Nations Development Programme (UNDP) conducted an audit of Making Budget and Aid Work (Project Nos. 56407 and 74281) (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 \$6 million. The following donors contributed to the Project: UNDP, Department for International Development and Canadian International Development Agency.

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 **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 concerns within Project management and the management of cash advances. Ratings per audit area and sub-areas are summarized below.

Audit Areas	Not Assessed/ Not Applicable	Unsatisfactory	Partially Satisfactory	Satisfactory
1. Organization and staffing				
2. Project management				
3. Operations				
3.1 Human resources	Satisfactory			
3.2 Financial and cash management	Unsatisfactory			
3.3 Procurement	Not Assessed			
3.4 Asset management	Satisfactory			
3.5 Information systems	Satisfactory			
3.6 General administration	Satisfactory			

Key issues and recommendations

The audit raised five issues and resulted in five recommendations, of which four (80 percent) 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.”

Project management (Issue 1)	<p><u>Delayed submission of reports and limited analysis of Project progress.</u> Some quarterly progress reports were submitted by the Project Manager to the Project Board with delays of at least six weeks. Further, the 2011 Annual Progress Report provided limited analysis of the achievement of intended Project results as defined in the Results and Resources Framework. Without the timely submission of reports and adequate assessment of Project results, programmatic issues may not be addressed and resolved immediately. OAI recommends that the Office ensure that: (a) annual progress reports submitted by projects include sufficient details to enable effective monitoring of progress toward achieving planned outputs and outcomes; and (b) quarterly progress reports are submitted in a timely manner.</p>
Finance and cash management (Issue 5)	<p><u>Inadequate controls over cash advances.</u> Cash advances totalling \$0.8 million were made to two Programme Assistants not directly involved in Project implementation activities. These advances were given to the Project personnel working in the provinces to cover the cost of workshops, including the payment of participant per diem and travel costs. The Project personnel did not adequately control these advances as they did not maintain a list of participants to monitor related expenditures. Furthermore, there was limited evidence that the participants who received per diem reimbursements actually attended the training. There was also inadequate segregation of duties. OAI recommends that the Office enhance controls over cash advances by: (a) ensuring that advances do not exceed the authorized limit and are managed by UNDP staff; (b) establishing a standard operating procedure for managing cash advances that includes adequate segregation of duties, and identifies the supporting documentation required prior to making payments to workshop participants; (c) making payments directly to the bank accounts of workshop participants whenever possible; and (d) undertaking spot checks, especially when large advances are involved to determine if workshop participants and other recipients were paid the correct amounts.</p>

Management's comments

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



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

I. Introduction

From 30 June to 14 August 2012, OAI conducted an audit of the Making Budget and Aid Work Project, which is directly implemented and managed by the UNDP Country Office in Afghanistan. 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 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. They also aim 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, Project management, 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 \$6 million.

II. About the Project

The Project is a five-year programme that started in 2007 with a budget of \$32 million. It has three main objectives, namely to: (a) assist in preparing a comprehensive policy based budget; (b) improve alignment and effectiveness of aid to support Afghanistan development goals; and (c) ensure that sustainable institutional capacity is built within the Ministry of Finance.

In 2011, Project activities included providing technical assistance in preparing the national budget, assisting in the preparation of the Aid Management Policy for off-budget financing as well as providing technical assistance to budgetary units and line ministries.

III. Detailed assessment

1. Organization and staffing

Satisfactory

OAI reviewed the Project's organizational structure and staffing, including the Human Resources Plan for 2011-2012, and the Letter of Agreement signed between the Office and the Ministry of Finance in February 2010. The Letter of Agreement was amended in May 2012 to include a provision allowing the Ministry of Finance to receive cash advances to undertake procurement for Project activities.

In accordance with UNDP policies, this type of Letter of Agreement is used in cases where a Government institution cooperates with UNDP and carries out activities as a responsible party on a project that is directly implemented by UNDP. A responsible party is defined as an entity that has been selected to act on behalf of the implementing partner, i.e. UNDP. A responsible party is directly accountable to the implementing partner in accordance with the terms of the agreement.

The Project had four personnel, including the Project Manager, under UNDP service contracts. In addition, the 2012 Human Resources Plan, which was approved in May 2012, included 147 international and national positions to be hired under government contracts and paid by UNDP.

2. Project management

Partially Satisfactory

OAI reviewed the Project Document, annual work plans, Letter of Agreement, quarterly and annual progress reports, and interviewed Office as well as Project personnel.

The control weaknesses noted in Project management are discussed below:

Issue 1 Delayed submission of reports and limited analysis of Project progress

According to the Project Document, the Project Manager must submit quarterly progress reports to the Office and to the Project Board. The Programme and Operations Policies and Procedures require the Project to report progress on programmatic outcomes and to establish indicators with baselines and targets in order to monitor progress towards achieving planned outputs and outcomes.

The 2011 Annual Progress Report provided details on activities, such as the number of training opportunities provided and budget reviews completed. However, the report provided limited analysis of the achievement of intended Project results as defined in the Results and Resources Framework of the Project Document. Specifically, the Project failed to report on the progress of results-based indicators in Output 1, “number of line ministries producing programme based budget” and Output 5, “percentage of Aid recorded.” Additionally, the mid-term evaluation highlighted the lack of a good Logical Framework, making it difficult to develop a clear picture of Project achievements and impact.

OAI noted that the reports for the fourth quarter of 2011 and first quarter of 2012 were submitted at least six weeks after each quarter had ended.

Without the timely submission of reports and adequate assessment of Project results, programmatic issues may not be addressed and resolved immediately.

Priority	High (Critical)
Recommendation 1:	The Office should ensure that: (a) annual progress reports submitted by projects include sufficient details to enable effective monitoring of progress toward achieving planned outputs and outcomes; and (b) quarterly progress reports are submitted in a timely manner.
Management Comments:	<input checked="" type="checkbox"/> Agreed <input type="checkbox"/> Disagreed
	The Project will ensure the timely submission of annual and quarterly reports and provide quality data to enable better analysis of progress towards the achievement of outputs and outcomes.

Issue 2 Infrequent Project Board meetings

The Programme and Operations Policies and Procedures state that the Project Board is responsible for making management decisions when guidance is required, including recommendations for approving Project plans and

revisions. According to the Programme and Operations Policies and Procedures, the Project Board is to meet annually at a minimum, although quarterly meetings are recommended.

During the audit period, the Project Board met only once. The Project Manager explained that the Project Board meetings were delayed as they were awaiting the development of an exit strategy before proceeding with the next meeting. Management commented that the main reason for infrequent Board meetings was the unavailability of Board members. OAI found that other responsibilities such as reviewing the Project's progress and providing overall guidance had not been fulfilled.

The lack of timely oversight may result in key Project decisions being delayed, which could impact the overall achievement of Project objectives.

Priority	High (Critical)
Recommendation 2:	
The Office should follow the suggested guideline on meeting frequency contained in the Programme and Operations Policies and Procedures by scheduling quarterly Project Board meetings.	
Management Comments: <input checked="" type="checkbox"/> Agreed <input type="checkbox"/> Disagreed	
The Office stated that more Project Board meetings were held in 2012 and management will continue to monitor the frequency of Board meetings.	

Issue 3 Inadequate implementation of exit strategy

According to the Programme and Operations Policies and Procedures, each project should ensure capacity development and create an exit strategy to ensure it leaves behind sustainable and resilient entities. The Project Document included an exit strategy with detailed targets to ensure a sustainable exit and institutional capacity building with the government institution.

However, the Project was not on track in achieving its exit strategy targets. The Project Document required the government institution to absorb Project costs and assume responsibilities by 2012. At the end of the audit fieldwork, the Office had continued to fully fund personnel costs in several units of the Budget Department, although the intention was to reduce the number of positions funded every year. Further, the exit strategy provided for Project-funded positions to be replaced by government personnel recruited from the Graduate Development Programme. However, this objective had not been met. The Office indicated that the government institution could not retain graduate personnel due to the availability of better opportunities outside of the institution.

Priority	Medium (Important)
Recommendation 3:	
The Office should assess progress being made in implementing the exit strategy and make necessary revisions based on the current situation and the reality on the ground, or if necessary, develop a new strategy which will facilitate the absorption of UNDP-funded positions by the government institution over a specific timeframe.	

Management Comments: Agreed Disagreed

The Office indicated that the exit strategy is expected to be completed by the end of March 2013 and fully implemented during the next three years.

Issue 4 Weak management of the Letter of Agreement

According to the Programme and Operations Policies and Procedures, the Office should use the standard Letter of Agreement template when entering into agreements with government entities to implement specific project activities, which are directly implemented by UNDP. Any amendments to the template should be approved by the Legal Support Office.

The Letter of Agreement signed with the government institution included a number of deviations from the standard template. Specifically, Clause 19 allowing UNDP to suspend the agreement had been omitted while Clauses 3, 7 and 8 which respectively related to recruitment of personnel, roles of the Project Coordinator and dealing with disagreements, had been included by the Office, even though they do not appear in the standard template.

Some clauses were also not followed. For example, Clause 10 referred to advancing funds to the government institution in accordance with the Schedule of Activities and Payments (Attachment 3 of the Letter of Agreement), but the Office was making direct payments for the Project. Also, Clause 3 indicated that relevant government labour laws should be followed when hiring personnel under government contracts, but UNDP hiring procedures were used instead.

According to the Project Manager, when hiring personnel under government contracts, UNDP procedures for engaging service contract holders were followed, and the government institution approved all successful recruitment actions. However, the Letter of Agreement was not amended to reflect the actual recruitment process used, including the corresponding roles and responsibilities, in order to prevent any future disputes. The Project was unable to explain these deviations from the Letter of Agreement.

OAI also noted that of the 32 recruitments selected for review, the government institution's approvals of the interview panel reports were missing for eight of them.

Without authorized approval of the changes from the standard Letter of Agreement, the Office might be making unauthorized commitments on behalf of UNDP.

Priority	High (Critical)
Recommendation 4:	
<p>The Office should ensure:</p> <ul style="list-style-type: none"> (a) that the Letters of Agreement signed with partners comply with the Programme and Operations Policies and Procedures and that any amendments are approved by the Legal Support Office; and (b) compliance with the provisions of the Letters of Agreement. 	
Management Comments: <input checked="" type="checkbox"/> Agreed <input type="checkbox"/> Disagreed	
<p>The Office indicated that it will ensure that terms and conditions in the Letters of Agreement are compliant with the Programme and Operations Policies and Procedures and followed by the government institution. If any amendments are required, approval will be obtained from the Legal Support Office.</p>	

3. Operations

Partially Satisfactory

3.1 Human resources

Satisfactory

Considering that OAI recently conducted an audit of the Office's overall human resources management, the review of this area focused mainly on the management of the Project's service contract holders.

OAI reviewed supporting documentation for the recruitment of all four UNDP service contract holders. Generally, the Project complied with the UNDP recruitment policy for service contract modality.

3.2 Financial and cash management

Unsatisfactory

During the audit period, the Office processed 542 vouchers totalling \$4.7 million, of which OAI selected 10 vouchers totalling \$0.8 million for detailed review. The Project Manager had been authorized to approve payments up to \$2,500, while payments exceeding \$2500 required approval by the Office.

There were inadequate controls over the management of cash advances as discussed below.

Considering the significance of the issues noted, this area was assessed as "unsatisfactory."

Issue 5 Inadequate controls over cash advances

In 2011, the Office had obtained approval from the Treasury to make cash advances of up to \$20,000 per provincial government personnel training workshop to implement Project activities. To reduce the inherent risks, payments should be made through a bank or via cheque.

During the audit period, several advances were issued to two Office Programme Assistants totalling \$0.8 million to cover training related costs (including the per diem of participants) and other Project activities. A number of advances released to the two Programme Assistants exceeded the limit of \$20,000, with the largest amount totalling \$172,000.

Controls over the advances were inadequate as documented procedures were not established to ensure accountability and reporting on the use of the funds that had been advanced, as discussed below:

- (a) The advances were released to the Office's Programme Assistants despite the fact that they were not directly involved in Project implementation activities. The Programme Assistants cashed the cheques and provided the cash to the Project's finance personnel either for safekeeping or for transfer to the personnel under government contracts in the provinces. There was significant risk of misuse, loss, or misappropriation of funds considering that different personnel in different locations were handling the cash without proper controls being in place.

The Office advised OAI that the two Programme Assistants holding UNDP fixed-term appointments had been designated to receive the advances, since all Project personnel were service contract holders and not UNDP staff, and hence were not authorized to receive cash advances. However, the cash was actually managed by these same service contract holders. The process also implied that Programme Assistants to whom the cheques were issued were accountable for demonstrating the good use of the funds they had received.

- (b) OAI reviewed 14 vouchers relating to the liquidation of advances totalling \$0.8 million, which had been used mainly to pay per diem and other expenditures for training participants. Documentation to support the validity of payments was inadequate. For example, the Project personnel had not prepared a list of

participants at the training events, which could have been used to monitor related expenditures for meals, supplies, and other incidentals. Furthermore, there was limited evidence to show that the participants who received per diem had actually attended the training, as daily attendance records were not always kept. Additionally, cash advances were used to pay for transportation and accommodation, without additional controls to ensure value for money was being obtained. There was also inadequate segregation of duties as the personnel under government contract, who had custody of the cash, also solicited quotes from different vendors, selected the vendors and ultimately made the payments to the vendors.

The issues discussed above occurred primarily because the Office failed to establish cash management standard operating procedures for use by the Project personnel. The lack of proper control procedures significantly increases the risk of misappropriation.

Priority	High (Critical)
Recommendation 5:	
<p>The Office should enhance controls over cash advances by:</p> <ul style="list-style-type: none"> (a) ensuring that advances do not exceed the authorized limit and are managed by UNDP staff (if this is not feasible, the Office should consult the Bureau of Management for guidance); (b) establishing a standard operating procedure for managing cash advances that includes adequate segregation of duties, and identifies the supporting documentation required prior to making payments to workshop participants; (c) making payments directly to the bank accounts of workshop participants whenever possible; and (d) undertaking spot checks, especially when large advances are involved to determine if workshop participants and other recipients were paid the correct amounts. 	
Management Comments: <input checked="" type="checkbox"/> Agreed <input type="checkbox"/> Disagreed	
<p>The Office stated that it established standard operating procedures to define the appropriate use and management of cash advances issued to Project personnel. It will also conduct regular spot checks and monitoring visits to ensure compliance with the established procedures, especially those advances released for the purpose of organizing workshops and training.</p>	

3.3 Procurement

Not Assessed

The Office was responsible for the Project's procurement of goods and services with a value of \$2,500 and above. The Project was responsible for preparing the annual procurement plan, raising e-requisitions in Atlas, and certifying satisfactory receipt of goods and services. During the audit period, the Office processed 92 purchase orders valued at \$0.5 million. As OAI planned a detailed audit of the Office's Procurement Unit in November 2012, OAI undertook a limited review of 11 purchase orders totalling \$0.2 million or 35 percent of the total to develop an understanding of the procurement process to assist in planning the aforementioned audit.

3.4 Asset management

Satisfactory

An earlier OAI audit reviewed asset management in UNDP Afghanistan (OAI Report No. 881) in December 2011 and resulted in an overall satisfactory rating. According to the asset listing as of 28 May 2012, the Project had 119 assets with a value of \$0.4 million. OAI conducted physical verification of 20 assets valued at \$293,821. Generally, the Project had established adequate controls over its assets.

No reportable issues were noted.

3.5 Information systems

Satisfactory

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

3.6 General administration

Satisfactory

Based on the review of relevant documents during the audit planning, OAI assessed this area as low risk. Therefore, no further fieldwork was performed. Furthermore, OAI noted that overall the Project had established adequate controls over general administration and travel-related transactions.

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 not included in this report.