



AUDIT

OF

FINANCIAL MANAGEMENT AND OVERSIGHT UNIT

IN

UNDP COUNTRY OFFICE IN AFGHANISTAN

Report No. 1731
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Report on the Audit of Financial Management and Oversight Unit in UNDP Afghanistan Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of the Financial Management and Oversight Unit of UNDP Afghanistan (the Office) from 25 September to 5 October 2016. 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 organizational structure (organizational structure of the Financial Management and Oversight Unit, delegations of authority, leadership/ethics and values, risk management, planning, monitoring and reporting).
- (b) Management of bank accounts.
- (c) Management of project closure.
- (d) Management of advances granted to national implementing partners.
- (e) Cash management (including project cash advances).
- (f) Management of cost recovery.
- (g) Government Contributions to Local Office Cost receivables.
- (h) Financial operations, revenue and expense management.

The audit covered the activities of the Financial Management and Oversight Unit from 1 January 2015 to 31 August 2016. The Office recorded programme and management expenditures of approximately \$985 million during the audit period. The last audit of the Financial Management and Oversight Unit was conducted by OAI in 2013. OAI had also conducted audits of projects implemented by the Office and the Security Unit during 2015 and 2016.

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

Overall audit rating

OAI assessed the Financial Management and Oversight Unit of the Office 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 delays in recovering costs for services provided, delays in closing projects, lack of project cash advance reports, Government Contributions to Local Office Costs not fully collected, and inadequate supporting documentation regarding General Ledger Journal Entries and Accounts Payable Journal Vouchers.

Key recommendations: Total = 5, high priority = 1

The five recommendations aim to ensure the following: (a) reliability and integrity of financial and operational information (Recommendation 5, medium priority), and (b) compliance with legislative mandates, regulations and rules, policies and procedures (Recommendations 1, 2 and 4, medium priority, and Recommendation 3, high priority).

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. The high (critical) priority recommendation is presented below:

Delays in recovering costs from other United Nations agencies and development projects (Issue 3)

The Office had been providing support services, such as finance, procurement, human resources, and travel administration to development projects and other United Nations agencies. However, the Office had delayed the recovery of costs incurred for providing these support services. For example, costs of services rendered from December 2014 to May 2015 were recovered in October 2015. Further, costs for January to September 2016 had not been recovered as the Office was in the process of billing these at the time of the audit fieldwork.

Recommendation: The Office should enhance its cost recovery for support services rendered to development projects and United Nations agencies by: (a) immediately recovering all costs for support services rendered from January to September 2016; and (b) establishing procedures for the recovery of costs for services rendered at regular intervals.

Implementation status of previous OAI audit recommendations: Report No. 1233, 10 December 2013.

Total recommendations: 7

Implemented: 7

Management comments and action plan

The Country Director accepted all of the 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.



Helge S. Osttveiten
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I. About the Office

The Office is located in Kabul, Afghanistan (the Country). The Office recorded programme and management expenditures of \$608 million during 2015 and \$377 million during January to August 2016. The Office faced significant challenges, both internally and externally, as opportunities for sustainable development were made more difficult by the security and political context and the socio-economic transition the Country was facing.

In early 2016, the Office requested the support of the Management Consulting Team to develop a Transformation Plan, realigning the resources of the Office around the functions and capacities needed to ensure it was “fit for purpose”. The Management Consulting Team undertook a mission from May to June 2016 and proposed various changes to be made to the Office’s structure (including the Financial Management and Oversight Unit), based on structural and business process reviews. This Transformation Plan was being implemented and was expected to be completed by the end of 2016.

II. Audit results

Satisfactory performance was noted in the following areas:

- (a) Governance and organizational structure. The Office had established adequate controls to ensure that the Financial Management and Oversight Unit had proper delegation of authority, planning, monitoring and reporting processes.
- (b) Management of bank accounts. The Office had established adequate controls in managing its bank accounts.¹
- (c) Management of advances granted to nationally implemented projects. The Office had established adequate controls and no exceptions were noted.

OAI made one recommendation ranked high (critical) and four 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 recommendation:

- (a) Enhance cost recovery for support services rendered to development projects and United Nations agencies (Recommendation 3).

Medium priority recommendations, arranged according to significance:

- (a) Implement the procedures on the financial closure of projects (Recommendation 1).
- (b) Ensure compliance with the ‘UNDP Programme and Operations Policies and Procedures’ by having adequate documentation supporting all transfers of expenditures and Accounts Payable Journal Vouchers (Recommendation 5).
- (c) Improve the management of cash advances (Recommendation 2).
- (d) Seek the support of the Office of Financial Resources Management and the Regional Bureau for Asia and the Pacific on the way forward to recover the outstanding Government Contributions to Local Office Costs (Recommendation 4).

¹ The bank reconciliation processes were undertaken by the UNDP Global Shared Services Unit based in Kuala Lumpur.

The detailed assessment is presented below, per audit area:

A. Management of project closures

Issue 1 Delays in financial closure of projects

The 'UNDP Programme and Operations Policies and Procedures' require all projects that have operationally ended to be financially closed within a 12-month period.

Based on a report generated from Atlas (enterprise resource planning system of UNDP) as at 31 August 2016, there were 109 projects that had either operationally ended or had a project end date of more than 12 months old. Office management indicated that there were extensive efforts towards financially closing projects in 2015 and 2016. In mid-2016, the Financial Management and Oversight Unit had forwarded the Office a list of 32 projects that had operationally ended more than 12 months prior and that had not been financially closed. The Office had been working on closing these projects on a priority basis and commented that the majority of these projects would be financially closed by October 2016. Subsequent to that, the Office would review all other projects that had operationally ended and would do the needful to financially close them in Atlas. Office management further commented that one reason for not financially closing projects on time was due to delays in the responses received from donors on the return or utilization of remaining unused contributions once a project's activities had been completed.

Projects that are not financially closed in a timely manner may result in unauthorized expenditures being charged to them.

| Priority | Medium (Important) |
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| Recommendation 1: The Office should implement the procedures on the financial closure of projects by: <ul style="list-style-type: none"> (a) timely monitoring and financially closing projects that have operationally ended; (b) reviewing and financially closing within a specific time frame all 109 projects that have operationally ended for more than 12 months or have a project end date of more than 12 months; and (c) considering communicating to the donors that, in the event responses are not received on the unused contributions within a specified timeframe, the Office will reallocate the unused funds to other projects. | |
| Management action plan: Since 2015, the Office has been giving priority to closing projects and refunding donors. It has expended significant resources in the last 18 months, to clear the backlog of project closures and related donor refunds. Further, a more robust monitoring system is under implementation, based on Atlas and dashboard reports, including oversight by the senior management team on this process. The Office also is also proactively engaging with donors, which has improved relations with them and has mitigated reputational risks. Estimated completion date: June 2017 | |

B. Cash management

Issue 2 Lack of project cash advance reports for monitoring purposes and delays in clearing advances

A project cash advance is a one-time advance issued to a custodian for a specific one-time project activity. The 'UNDP Programme and Operations Policies and Procedures' require offices to clear these project cash advances within 14 days after the last day of the project activity.

The Office granted 100 project cash advances amounting to \$0.6 million during the audit period. The audit reviewed 15 samples of project cash advances granted to personnel to carry out various project activities together with their corresponding clearances and noted the following exceptions:

- (i) The 'UNDP Programme and Operations Policies and Procedures' require that offices use the project cash advance Status Monitor report to ensure that all one-time project activities concluded by the 23rd of the month do not have outstanding advances on the last day of the month. Further, at each quarter-end or at each UNDP financial closure date, the assigned Finance Associate should prepare the project cash advance Reconciliation Schedule report and the Operations Manager should review and certify it. The audit team noted that the Office did not prepare these two reports for monitoring project cash advances. Instead, the Finance Associate used the Account Activity Analysis report from Atlas to monitor the status of project cash advances.
- (ii) The audit team noted delays ranging from 3 to 35 days in five project cash advances amounting to \$72,600 out of 15 cases reviewed. The Office's management explained that these delays were mainly due to the fact that the project activities were carried out in remote provinces and as such required additional time to clear documents that were submitted to the Project Management Team and to the Office.

Failure to manage and monitor project cash advances would may lead to the risk of these advances not being cleared timely in a manner.

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| Priority | Medium (Important) |
| Recommendation 2: The Office should improve the management of project cash advances by: <ol style="list-style-type: none"> (a) preparing the Status Monitor report and Reconciliation Schedule report and having these reviewed by a designated staff member to enhance management of project cash advances; and (b) enhancing efforts to ensure that project cash advances are cleared within 14 days as required by the Treasury Unit. | |
| Management action plan: Whilst effective controls were in place to monitor and control outstanding project cash advances, the Office acknowledged that procedures used were not fully compliant with the 'UNDP Programme and Operations Policies and Procedures'. The Office in the future will generate the Status Monitor report and project cash advance Reconciliation Schedule reports and have them reviewed and signed by the Office's Chief Finance Officer or Deputy Country Director (Operations). | |

Estimated completion date: January 2017

C. Management of cost recovery

Issue 3 Delays in recovering costs from other United Nations agencies and development projects

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 (projects and programmes) or service. With respect to development activities, direct project costs are used to budget for and recover the costs of activities that fall under the following two harmonized cost classification categories: programme activities and development effectiveness activities.

The Office had been providing support services, such as finance, procurement, human resources and travel administration to development projects and other United Nations agencies. In 2015, the Office recovered a total of \$2 million from development projects and United Nations agencies for support services rendered to them. However, the Office delayed the recovery of costs for these support services. For example, costs of services rendered from December 2014 to May 2015 were recovered in October 2015. Similarly, costs for January to September 2016 amounting to \$1.5 million had not been recovered, as the Office was in the process of billing these at the time of the audit fieldwork.

The Office's management indicated that the delay was mainly due to the time taken to understand the direct project cost guidelines and due to confusion on the types of services that can be cost recovered from development projects.

Failure to fully recover costs could negatively affect the Office's ability to achieve agreed results.

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| Priority | High (Critical) |
| Recommendation 3: | |
| The Office should enhance its cost recovery for support services rendered to development projects and United Nations agencies by: | |
| (a) immediately recovering all costs for support services rendered from January to September 2016; and | |
| (b) establishing procedures for the recovery of costs for services rendered at regular intervals. | |
| Management action plan: | |
| As at mid-November, recoveries for January to April 2016 have been processed and all projects and agencies have been contacted for the period from May to September 2016, to provide the necessary Chart of Accounts, financial authorizations or cash transfers. | |
| Estimated completion date: January 2017 | |

D. Government Contributions to Local Office Cost receivables

Issue 4 Government Contributions to Local Office Costs not fully collected

According to the provisions of the Standard Basic Assistance Agreements that govern UNDP operations in programme countries, host governments are expected to contribute towards the costs of Country Offices. The annual Government Contributions to Local Office Costs (GLOC) cash targets are communicated to offices by the Office of Financial Resources Management.

The audit team noted that GLOC amounting to \$4.2 million was outstanding for the period from 2001 to 2015. Office management had written to the Government on six occasions from 2003 to 2014 requesting the outstanding GLOC amount, but despite these efforts, they had been unable to collect the outstanding amount.

Failure to collect GLOC may deprive the Office of financial resources, which could negatively affect the Office's ability to achieve agreed results.

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| Priority | Medium (Important) |
| Recommendation 4: | |
| The Office should seek the support of the Office of Financial Resources Management and of the Regional Bureau for Asia and the Pacific on the way forward to recover the outstanding Government Contributions to Local Office Costs. | |
| Management action plan: | |
| The Office will contact Office of Financial Resources Management and the Regional Bureau for Asia and the Pacific to identify how to try and recover Government Contributions to Local Office Costs in the country specific context. | |
| Estimated completion date: December 2016 | |

E. Financial operations – expense management

Issue 5 Inadequate documentation supporting General Ledger Journal Entries and Accounts Payable Vouchers

According to the 'UNDP Programme and Operations Policies and Procedures', there should be adequate supporting documentation for all General Ledger Journal Entries (GLJEs) and Accounts Payable Journal Vouchers (APJVs).

The review of various types of journal entries showed a number of weaknesses with regard to the supporting documentation, as follows:

- During the period under review, the Office had approved approximately 500 GLJEs with a volume of \$769,786,511. Out of 18 GLJEs reviewed (with a volume of \$117,278,747), 13 varying from \$70,000 to \$29 million had insufficient supporting documentation justifying the reason for the transfer of expenditures between donors in the same project from one output to another. The Office's management informed OAI that they were aware of this weakness and had recently taken action to ensure that there was detailed documentation for approving GLJEs.
- APJVs are used to clear advances granted to implementing partners for nationally implemented projects. The documentation supporting the APJVs reviewed was in general quite substantive. However, in four cases amounting to \$1.5 million, the supporting documentation provided by the Office was not directly relevant to the APJV it referred to.

OAI had raised a similar issue on the lack of supporting documentation in processing GLJEs in the previous audit (Report No. 1233). The respective recommendation was assessed as implemented by OAI based on corrective actions taken by the Office; however, the issues identified in this audit require that a new recommendation is being made in this respect.

Transferring large amounts of expenditures from one project to another without adequate supporting documentation could lead to invalid transactions and incorrect recording of expenses.

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| Priority | Medium (Important) |
| Recommendation 5: | |
| The Office should ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' by having adequate documentation supporting all transfers of expenditures and Accounts Payable Journal Vouchers. | |
| Management action plan: | |
| The Office agreed and stated that a number of steps have already been taken this year to address this. | |
| Estimated completion date: March 2017 | |

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 not included in this report.