



March 20, 2017

All ARTF Donors

Dear ARTF Donors:

***Subject: Fiscal Year 1394 Audit Reports of Afghanistan Reconstruction Trust Fund (ARTF) Financed Projects***

The World Bank has concluded its review of the audit reports on the financial statements of the ARTF-financed recurrent and investment operations for the Fiscal Year 1394 (year ended December 21, 2015).

**I. Audit Process**

All ARTF projects are audited annually by the Supreme Audit Office (SAO) of the Islamic Republic of Afghanistan with technical assistance from an international audit firm. Technical support for the FY1394 audit was provided by S.N. Nanda Chartered Accountants, India. As an integral part of its supervision of the ARTF-financed activities, the World Bank's Financial Management team and project task team leaders review the audit reports and management letters, discuss the auditors' observations with the government counterparts and follow-up on the corrective action and resolution of key audit findings. Ineligible expenditures are followed through for recoveries. In addition to the external audit, the Monitoring Agent provides another level of review of the expenditures pertaining to the Recurrent Cost Window. While discussions with the government counterparts are underway for FY1394 audit findings, we would like to share the initial findings from the audit reports.

**II. Audit Results – Investment Projects**

Audit reports covering 24 grants of ARTF investment operations, presented in 20 audited financial statements<sup>1</sup> for FY1394 were received. These were reviewed and accepted by the World Bank as fulfilling the financial covenant 4.01(b) of the respective ARTF Grant Agreements.

A total of 18 out of the 20 audit reports had unqualified<sup>2</sup> (clean) audit opinions for FY1394, compared to 21 out of 23 audit reports for FY1393. All the audit reports for FY1394 were received before the deadline of June 21, 2016. A comparative analysis for the last 5 fiscal years is presented in Table 1 below.

The FY1394 audit related issues have been communicated to the relevant line ministries and the Bank is following up to ensure resolution. The Bank has due internal processes to address and resolve ineligible expenditures in a timely manner, and it is anticipated that all ineligible and questionable expenditures will be resolved by June 30, 2017.

<sup>1</sup> Four projects out of 24 ARTF projects each have two grants attached to them

<sup>2</sup> The Afghanistan Resource Corridor and Afghanistan Power System Development Project had qualified audit opinions.

**Table 1 - Comparative Analysis of FY1390-1394 Audit Results**

ARTF Investment Projects Audit Results FY1394									
FY	# of Audit Report Received	# of Report Received on Time	Months Elapsed after Due Date	# of Unqualified Audit Reports	FY Total Expenditures in US\$ (Millions)	Ineligible Expenditures		Unsubstantiated/ Questionable Expenditures	
						In US\$ (millions) approx	In % of Total	In US\$ (millions) approx	In % of Total
1394	20	20	0	18	564	0.304	0.05	0.198	0.035
1393	23	15	1.3	21	584	2.93	0.50	1.388	0.240
1392	25	24	0.5	21	523	2.20	0.42	0.019	0.004
1391	22	17	1	20	397	2.50	0.60	0.283	0.070
1390	21	10	5	20	321	0	0	0.783	0.240

### III. Audit Results – Recurrent Cost Window

The auditors reported that the financial statements present fairly the receipts and payments under the trust fund in the year. However, there is a qualification in the opinion (limitation in scope) because the auditors could not visit ten<sup>3</sup> of the provinces due to security reasons. Because the visits were determined by external circumstances, and were not the result of a risk-based sample the auditors therefore reserve judgment on the expenditures in these provinces. These expenditures represent 12.8 percent (US\$ 161.99 million) of the total recurrent expenditures that were submitted.

Fortunately, the ARTF Recurrent Cost Window Monitoring Agent that provides independent verification of the recurrent cost expenditures, was able to conduct site visits to all the provinces except two due to security challenges<sup>4</sup>.

In addition to ineligible expenditures totaling US\$ 47.06<sup>5</sup> million which were identified by the ARTF Monitoring Agent<sup>6</sup>, the SAO audit report identified additional ineligible expenditure of US\$ 3.95 million representing 0.4 percent of the total recurrent expenditures that were submitted. As this is significantly less than those identified by the Monitoring Agent, it can therefore be concluded that the amount of ineligible expenditures identified by the auditors have already been considered as ineligible, and not reimbursed under the ARTF Recurrent Cost Window.

### IV. Conclusions

**Recurrent Cost Window-** The auditors also prepared a Management Letter for the FY 1394 audits which sets out their findings. The principle recommendation is to address ineligibility under the Recurrent Cost Window in respect of lack of supporting documents, inconsistent expenditures with rules and decrees, and failure to comply with procurement procedures. Part of the measures to address ineligible expenditures under the Recurrent Cost Window include the Monitoring Agent providing detailed monthly ineligibility reports to the MoF for follow up and also conducting workshops for the line ministries.

<sup>3</sup> Ghazni, Kunarh, Nooristan, Takhar, Kunduz, Sar-e-pul, Zabul, Faryab, Badghis and Farah.

<sup>4</sup> Paktika and Nooristan were inaccessible owing to high security risks

<sup>5</sup> Some of the ineligible expenditures and expenditures for which supporting documents were not provided were reported in AFN. An exchange rate of 60 AFN to 1 USD has been used to convert the figures to USD.

<sup>6</sup> Source - Monitoring Agent Annual Management Report for FY1394




**Strengthening internal controls:** The World Bank, with the support of the Monitoring Agent, has commenced a number of new initiatives to strengthen the internal controls and compliance of recurrent cost expenditure. Control checklists have been developed for Government staff to follow when executing payroll and O&M expenditure. Workshops have been undertaken in October 2016, and February 2017 to provide technical training on expected controls and more general principles of effective Government procurement. On a more regular basis, the Monitoring Agent provides a detailed monthly ineligibility report to the MoF listing key reasons for non-compliance and discusses the follow up actions required. This is in addition to regular technical briefing notes provided on specific issues (most recently, pension ineligibility which highlights Ministries and geographic locations and remedial actions, and controls to be implemented.) The Monitoring Agent escalates any emerging issues or concerns to the World Bank for appropriate follow up.

**Investment Projects-** On the investment projects, there is a need to improve internal controls and internal audit. The current internal audit arrangement was put in place in FY1394 and mostly focused on a centralized approach through the Internal Audit department of the MoF. In line with the government regulations, there is need to decentralize this function to the various ministries. The internal audits along with recommendations coming from the annual audits, and Bank supervision contribute to strengthening the internal controls, and positive results are visible progressively year after year.

For any questions relating to the ARTF investment projects or the Recurrent Cost Window, please contact the ARTF Coordinator; [REDACTED]

Sincerely,



Stephen Ndegwa  
Acting Country Director for Afghanistan  
South Asia Region

cc. [REDACTED]

Annex 1

S.No.	Project ID	Project Name	ARTF Grants	Related Grants	Total Payment as per FS	Audit Opinion	Ineligible Expenditures		Unsubstantiated Expenditures	
							Eq. USD	Eq. USD	Eq. USD	Eq. USD
1.	P106259	Afghanistan - Second Education Quality Improvement Program	93962	H3540	43,668,470	Unqualified	-	-	5,849	-
2	P110407	AF Rural Enterprise Development Program	98045	H5310	5,777,887	Unqualified	-	-	-	-
3	P111943	Afghanistan Power System Development Project	93513	None	4,406,696	Qualified	1,200	-	46,742	-
4	P117103	National Solidarity Program III	98459	H6030	184,702,819	Unqualified	2,550	-	815	-
5	P118028	AF: ARTF-2nd Judicial Reform Project	12533, 11825	None	3,749,032	Unqualified	-	-	-	-
6	P120397	Afghanistan Agricultural Inputs Project	15003, 99595	None	6,083,303	Unqualified	-	-	42,932	-
7	P120398	AF On-Farm Water Management	99074, 96991	None	3,681,671	Unqualified	-	-	221	-
8	P120427	Public Financial Management Reform II	10024	None	18,759,641	Unqualified	-	-	-	-
9	P122235	AF Irrigation Restoration and Development Project	12029	H6810	18,877,295	Unqualified	-	-	4,213	-
10	P123845	Afghanistan Capacity Building for Results Facility	11447	None	7,278,314	Unqualified	-	-	-	-
11	P125597	Kabul Municipal Development Program	17016, 14211	None	11,885,956	Unqualified	29,703	-	-	-
12	P125961	Afghanistan Rural Access Project	13093	H7920	107,335,971	Unqualified	-	-	775	-
13	P129663	System Enhancement for Health	15005	H8290, HRBF 95691	111,880,705	Unqualified	-	-	1,529	-
14	P132742	Afghanistan - Second Skills Development Project	13393	H8340	8,924,143	Unqualified	-	-	-	-
15	P132944	Naghlu Hydropower Rehabilitation Project	14861	None	214,936	Unqualified	-	-	-	-
16	P143841	National Horticulture and Livestock Productivity Project	13820	None	23,627,684	Unqualified	-	-	1,361	-
17	P145443	Afghanistan Resource Corridor Project	14845	None	683,059	Qualified	270,669	-	-	-
18	P146015	Non-Formal Approach to Training Education and Jobs in Afghanistan Project	16354	None	1,059,683	Unqualified	-	-	-	-
19	P146184	Higher Education Project	15577	None	985,915	Unqualified	-	-	93,419	-
20	P131864	Kabul Urban Transport Efficiency Improvement Project	17061	None	9,812,540	Unqualified	-	-	-	-
<b>TOTAL</b>					<b>564,471,577</b>			<b>304,122</b>	<b>197,856</b>	