



November 4, 2020

All Afghanistan Reconstruction Trust Fund (ARTF) Donors

Dear ARTF Donors:

Subject: Fiscal Year 1397 Audit Reports of Afghanistan Reconstruction Trust Fund (ARTF) – Financed Projects

The World Bank (WB) has concluded its review of the audit reports on the financial statements and management letters of the ARTF-financed recurrent and investment operations for the Fiscal Year 1397 (year ended December 21, 2018). This letter describes the audit process, including an additional layer of independent quality review introduced in this round of annual audits, summarizes the audit findings, provides a comparative analysis of the FY1397 audits with the immediate prior four fiscal years, and attaches a list of ARTF-financed investment projects with audit opinions.

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. For the Fiscal Year 1397 (2018) audits, the SAO was unable to recruit a firm. With the WB's approval, SAO elected instead to hire individual international audit consultants to conduct the audits of ARTF/IDA financed projects. Onboarding the international audit consultants required more time than initially projected. Therefore, SAO and the WB agreed on an extended deadline of December 21, 2019, and the WB received all audit reports within the extended deadline.

As an integral part of its supervision of ARTF-financed activities, the WB financial management team and project task team leaders review audit reports and management letters. The teams discuss the auditors' observations with the government counterparts, agree and follow up on corrective actions to implement audit recommendations, and resolve key audit findings. These measures can include seeking a refund of ineligible expenditures, if identified.

The FY1397 audit cycle introduced an additional layer of review. The WB and SAO agreed to procure an independent third-party quality assurance review of selected ARTF project audits conducted by SAO. The ARTF third-party monitoring agent (TMA) conducted this independent quality assurance, reviewing SAO audit documentation and reports for four large investment projects.¹ The overall objectives of the review were to assess whether audit opinions expressed by the SAO were supported by evidence gathered from the work performed and whether the audits had been conducted in an effective and efficient manner. The review focused on 1) the quality of audit management letters, 2) SAO staff allocation and resourcing for the

¹ Citizens' Charter Afghanistan Project, EQRA, National Horticulture and Livestock Productivity Project, and the Afghanistan Rural Access Project. The audits for these four projects were selected for quality assurance review because of the materiality of disbursements and fiduciary risks assessed as high.

project audits, and 3) SAO's compliance with the International Standards of Supreme Audit Institutions (ISSAIs), developed by the International Organization of Supreme Audit Institutions, during planning, risk identification and mitigation.² The review, completed in June 2020, noted significant improvements in the quality of FY 1397 audit letters relative to past years, and offered recommendations on staffing allocation and audit documentation and reporting to ensure that audits comply with relevant ISSAI standards. The findings of this quality assurance review have been discussed with the SAO, and measures for incorporating recommendations in future SAO audit reports have been agreed.

II. Audit Results – Recurrent Cost Window

Recurrent Cost Window (RCW) expenditures receive two layers of review under the enhanced fiduciary control framework. The ARTF TPMA reviews expenditure eligibility for each withdrawal application made by the Government before disbursements are made. Supreme Audit Office auditors then review financial statements after the close of the fiscal year.³ SAO auditors reported that the FY 1397 statements present fairly the receipts and payments under the trust fund for the year. The auditors have covered 14 provinces besides the central ministries and one independent office with an overall coverage of 13.48% of total operating expenditures.

The SAO reported ineligible expenditures totaling US\$ 1.31 million that did not meet the eligibility requirements for disbursement through the ARTF Recurrent Cost Window. In the same period, the ARTF TPMA, reviewing a larger sample of expenditures, identified ineligible expenditures totaling US\$ 81.1 million. It can therefore be concluded that the amount of ineligible expenditures identified by the auditors had already been considered as ineligible, and as a result had not been disbursed under the ARTF RCW.

III. Audit Results – Investment Projects

Audit reports covering 28 grants of ARTF investment operations (including five project preparation grants), presented in 32 audited financial statements⁴ for FY1397, were received. These were reviewed and accepted by the WB as fulfilling the financial covenant 4.01(b) of the respective ARTF Grant Agreements.

The auditors have given 26 unqualified (clean) audit opinion. The auditors issued two qualified audit opinions, for the EQUIP II and Afghanistan Extractives for Development Project Preparation Grant FY1397 financial statements, because in the auditors' view, certain project expenditures did not fully comply with the conditions established in applicable grant agreements. Auditors issued a qualified opinion for EQUIP II in line with issues that were separately identified during the WB in-depth fiduciary review of the project. (The in-depth fiduciary review was completed and closed as of February 2020.) Auditors issued a qualified opinion for the Afghanistan Extractives Sector for Development Project Preparation Grant as a result of differing interpretations as to the compliance with GoIRA and WB standards of a modest amount of

² The quality assurance review was not an audit and did not incorporate a substantive test of transactions.

³ RCW disbursements for FY 1397 included expenditure reimbursement of ARTF Recurrent and Capital Costs and Fiscal Stability Facility instruments, as well as tranche payment of the Incentive Program – Development Policy Grant (IP-DPG). WB policy does not require audits of financial statements for policy grant operations. However, the RCW financial statements subject to audit cover the entire civilian recurrent expenditure. Moreover, the ARTF TPMA continues to monitor recurrent government expenditure, thus providing an additional layer of review.

⁴ Four projects out of 28 ARTF projects each have two grants attached to them.

project-funded travel expenses. A comparative analysis summarizing audit results for FY 1397 and the preceding four fiscal years is presented in Table 1 below.

Table 1 - Comparative Analysis of FY1393-1397 Audit Results

ARTF Investment Projects Audit Results FY1397 – Excluding RCW									
FY	Number of Audit Reports		Timeliness		FY Total Expenditures in US\$ (Millions)	Ineligible Expenditures		Unsubstantiated/ Questionable Expenditures	
	Received	Unqualified	Number of Audit Reports Received by Deadline ⁵	Months Elapsed after Due Date		In US\$ (millions) approx. ⁶	As Percent of Total Expenditures	In US\$ (millions) approx.	As Percent of Total Expenditures
1397	28	26	28	0	411	0	0	16.4	3.98
1396	25	25	25	0	453	0	0	2.5	0.55
1395	22	22	22	0	478	0.022	0.004	7.645	1.599
1394	20	18	20	0	564	0.304	0.05	0.198	0.035
1393	23	21	15	1.3	584	2.93	0.50	1.388	0.240

The external auditors prepared 28 management letters which together reported a total of 221 audit observations. The observations have been communicated to the relevant line ministries through formal audit review letters. Over the past months, the WB team organized a series of audit report review meetings with the projects and auditors to agree on actions for the resolution of the audit observations. The WB team has received responses along with supporting documents for all key observations, which are being reviewed by the WB team. The WB is following up to ensure resolution of all audit observations as per the agreed timelines.

IV. Conclusions

Overall, the quality of audit reports was assessed as Satisfactory; however, the SAO remains dependent on international technical assistance to complete ARTF audits. The ARTF-financed Fiscal Performance Improvement Support Project (December 2017-December 2022) includes an activity that aims to build the SAO's capacity independently to conduct these audits. In addition, to strengthen the overall control environment of ARTF projects, the WB has implemented several initiatives under the umbrella of the enhanced fiduciary control framework supported by the ARTF Anti-Corruption and Results Monitoring Action Program (ACReMAP) window that aim to improve financial management under ARTF-financed projects, enhance the quality of projects' expenditure documentation, and improve implementation of audit recommendations. These efforts include:

1. *Improving project-level financial management*: A comprehensive Financial Management Manual and training modules for the project financial management staff. The projects began applying the manual from February 22, 2019, and the Ministry of Finance circulated an updated version of the manual at the start of FY1399 (2020) with all the projects.

⁵ The extended deadline of December 2019 applied for the FY1397 audits.

⁶ Approximate values are reported because many transactions are reported in Afghani; values for the audit summaries are calculated using the exchange rate applicable at the close of the year, which may not have been the exchange rate that applied on the day of the transaction.

Annex: ARTF Investment Projects Audit Results Summary – FY 1397

S. NO	PROJECT ID	PROJECT NAME	ARTF GRANT NO.	IDA GRANT NO.	AUDIT OPINION	NO. OF OBSERVATIONS	REPORTED EXPENDITURES	INELIGIBLE EXPENDITURES	QUESTIONABLE EXPENDITURES
1	P106259	Second Education Quality Improvement Program	93962	H3540	Qualified	12	10,649,068	-	2,815,721
2	P110407	AF Rural Enterprise Development Program	A3502	H53010	Unqualified	6	3,380,847	-	17,662
3	P120397	Afghanistan Agricultural Inputs Project	15003, 99595	-	Unqualified	12	10,649,068	-	-
4	P120398	AF On-Farm Water Management	99074, 96991	-	Unqualified	11	13,686,265	-	20,180
5	P120427	Public Financial Management Reform II	10024	-	Unqualified	4	2,885,561	-	1,375
6	P122235	AF Irrigation Restoration and Development	12029	H6810	Unqualified	10	19,865,607	-	11,690
7	P123845	Afghanistan Capacity Building for Results Facility	11447	-	Unqualified	11	10,649,068	-	-
8	P125597	Kabul Municipal Development Program	17016 14211	-	Unqualified	7	11,532,173	-	-
9	P125961	Afghanistan Rural Access Project	13093	H7920	Unqualified	7	33,285,739	-	2,185
10	P129663	System Enhancement for Health Action in Transition	15005	-	Unqualified	9	67,009,077	-	848
11	P131228	DABS Planning Capacity and Support Project	A2026	-	Unqualified	4	252,082	-	7,801
12	P131864	Kabul Urban Transport Efficiency Improvement Project	17061	-	Unqualified	9	17,435,881	-	-
13	P132944	Naghlu Hydro Power Rehabilitation Project	A1691 14861	-	Unqualified	4	7,157,509	-	-
14	P143841	National Horticulture and Livestock Productivity Project	13820	-	Unqualified	10	24,356,096	-	-

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15	P146015	Non-Formal Approach to Training Education and Jobs in Afghanistan	16354	-	Unqualified	5	425,812	-	-
16	P146184	Higher Education Development Project	15577	-	Unqualified	12	13,765,371	-	238,024
17	P149410	CASA-1000 Community Support Program	17012	-	Unqualified	3	53,151	-	-
18	P156225	Support to Afghan Land Authority Project - PPG	A1898	-	Unqualified	5	1,630,511	-	46
19	P156894	Afghanistan Digital CASA - PPG	A2907	-	Unqualified	3	372,674	-	-
20	P157035	Afghanistan Technical Assistance Facility Project	A2839	-	Unqualified	6	220,329	-	6,621
21	P158768	Public Private Partnerships and Public Investment Advisory Project	A7087	D2840	Unqualified	7	236,708	-	-
22	P159378	Education Quality Reform in Afghanistan	A8009	D3810	Unqualified	7	9,420,304	-	-
23	P159655	Fiscal Performance Improvement Support Project	A6272	D2630	Unqualified	8	14,379,132	-	61,886
24	P160567	Citizens' Charter Afghanistan Project	A3827	D1390, D2130	Unqualified	15	133,770,217	-	13,194,706
25	P161728	Afghanistan Placing Labor Abroad and Connecting to Employment Domestically (PLACED) Project - PPG	A8312	-	Unqualified	6	109,783	-	2,346
26	P163267	Women's Economic Empowerment National Priority Program - PPG	A5400	-	Unqualified	10	177,939	-	-
27	P164443	Women Economic Empowerment and Rural Development Project	A8443	D3840	Unqualified	5	1,223,305	-	-

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28	P170179	Afghanistan Extractive for Development Project - PPG	A4809	-	Qualified	13	2,284,114	-	23,054