

ARTF Donor Committee Meeting
19 March 2008

Administrator's Discussion Note:
Fiduciary Oversight of ARTF Funded Recurrent Costs

Summary

Given the Ministry of Interior's experience with provincial payrolls and the overall security situation in Afghanistan, some concern has been expressed on the risks associated with the provincial payrolls financed by ARTF Recurrent Cost (RC) component. This note intends to present to the donors the fiduciary arrangements for the RC and explain how these respond to new information and changes in circumstances.

Although circumstances with civilian payrolls are different than those of the Ministry of Interior and ARTF monitoring of provincial payroll in the past indicated low risk of abuse, the risk assessment and, if appropriate, the work program of the Monitoring Agent should nevertheless be updated in view of the current situation.

The risk of non performance by civil servants, however, is not assessed or mitigated by the current ARTF RC oversight arrangements. This misuse arises where payroll is paid to bona fide employees who present evidence of attendance but do not perform any duties. This risk is addressed by supervision in the line ministry, interventions by the Civil Service Commission and the use of the centralized tashkeel controls. It is, however, most effectively reduced by the expansion of the Verified Payroll Program (VPP) which implies the elimination of reliance on the Bonded Trustee for payroll distribution. The MoEd is committed to an accelerated implementation of the VPP (30,000 in 1387, 50,000 in 1388) and given the significance of MoEd in the total provincial payroll costs this expansion would significantly mitigate all key payroll risks including non-performance.

Since Operations and Maintenance (O&M) expenditures are primarily incurred in Kabul, the security situation in the provinces does not significantly impact the ability of the Monitoring Agent to review O&M transactions.

In response to the new information and changing circumstance, the MA will:

- update the risk assessment of provincial payrolls by testing the 1386 payroll in all 17 green zone provinces which together total 60% of the provincial payrolls¹
- make use of MoF Internal Audit for the 1386 payroll tests in the red zone provinces.
- plan site visits for payroll testing of 1387 in response to the expansion of the VPP, specifically:
 - substantiate that the VPP is in place, assess the implementation and periodically verify that the payroll is processed through the VPP.

¹ It is estimated that given the low value of individual payroll and the high eligibility to date, the impact of this additional monitoring on ineligibility will not be significant. This additional payroll testing will draw resources from O&M monitoring where impact on eligibility might be higher.

- monitor in the remaining provinces the basis of the 1386 provincial monitoring results

Introduction

This note intends to present the fiduciary arrangements for the RC and explain how these respond to new information and changes in circumstances. The fiduciary arrangements for carrying-out, reviewing, reimbursing and reporting recurrent cost expenditures under the ARTF include the following arrangements (see Annex 1 for detail):

1. Government's budget execution arrangements grounded in the centralization of accounting and payments in Treasury and processed in AFMIS. The arrangements include the segregation of duties between the budgetary units which authorize uses of funds and the MoF which reviews, approves, disburses, records and reports transactions. Internal audit in the MoF is beginning to look at the compliance with controls throughout the Ministry.
2. Ongoing monitoring of MoF submissions for reimbursement by an agent of the World Bank referred to as the Monitoring Agent (MA). This MA is engaged by the World Bank and assists the Administrator fulfill its fiduciary responsibilities by carrying-out agreed upon procedures but does not offer an opinion on the ARTF RC financial statements. The results of the Monitoring Agent's work are reported by the Administrator in the ARTF quarterly reports.
3. Independent annual audit by the Auditor General of Afghanistan (CAO) with the support of Deloitte of India. The auditor is independent of the MoF and of the World Bank and his report is circulated to the donors.

Provincial Payrolls

Concern has been expressed that payrolls reimbursed by the ARTF RC may not be supported by bona fide employees who are rendering full time service. This risk may be more acute in the provinces where there is less monitoring and are not visited by the external auditors because of security concerns.

A recent survey by the US Army found that 20% of the Ministry of Interior (MoI) provincial payroll head count did not correspond to actual staff reporting to duty. The risk of this abuse in the MoI may be higher than in the non-security ministries because of the rapid rise in recruits of police and the high staff rotation which makes this payroll more susceptible to unsubstantiated payments than the civilian payrolls which the ARTF finances.

These survey results led the MoI to accelerate the implementation of the Verified Payroll Program (VPP) in the provinces. The VPP verifies that payroll matches personnel records and that the payment goes to the same staff whose names appear in the files. This addresses both the risk of i, "ghosts" payroll i.e. payroll payments which are not supported by an employment contract who submit evidence of attendance and ii, to some extent, the risk on non-performance i.e. staff not performing any duties. This latter risk is mitigated by the direct deposit to employees bank accounts or other direct payment mechanisms implied in the VPP because it eliminates the use of the Bonded Trustees who otherwise are used to collect the total of a unit's payroll for distribution and may have incentives to keep the names of non-performing staff on the payroll lists. Currently there are 90,000 employees government-wide paid through the VPP , including 26,000 in provinces.

Provincial Payrolls Financed by the ARTF

All civilian line ministries, except the Ministry of Education (MoEd), have had stable levels of staffing and payroll expenditure over the reconstruction period which allows the MA to react and investigate any significant increase or decrease in Head Count Data Base². MoEd, on the other hand, has been both recruiting and reducing its head count during reconstruction.

MoEd staff represent 75% of the total of provincial civilian service. In the first half of 1385 a census was carried out of the entire ministry to determine whether payroll entries corresponded to actual persons with bona fide employment contracts. The results aligned very closely with the totals of the Head Count Data Base which records for each month the number of staff in each payroll unit actually receiving pay. This is the same type of verification that the ARTF Monitoring Agent does in the site visits to establish eligibility of payroll costs.

As a result of the destruction of schools and shifts in population over the last decades teachers in some locations were left without schools but never left the payroll. As such the MoEd also conducted reviews of payroll over the reconstruction whereby the Ministry sought to establish whether these bona fide employees were not just submitting evidence of attendance but whether they were performing any duties. Based on these tests 3000 staff were removed from the payroll in 2005 but a nationwide *purging* of the payroll will only proceed once employees are documented and processed in a personnel registry with unique identification numbers and matched to positions or demand based on the corresponding district student population.

This work is underway and is aligned with the Verified Payroll Program of the Ministry of Finance. The MoEd has already completed gathering data on its staff across Afghanistan which is the first stage of VPP. This data will be updated in an Access database being managed by MoEd by end of April 2008. A target of expanding VPP by including 30,000 additional MoEd staff is set for 1387 and 50,000 for 1388.

Non Performance

This risk of non-performance by staff on the payroll list (whether or not they themselves collect the salaries) is not addressed by the ARTF Monitoring. This risk is addressed by supervision in the line ministry, interventions by the Civil Service Commission and the use of the centralized tashkeel controls; it is also reduced by the expansion of the Verified Payroll Program.

The payroll tests by Monitoring Agent go as far as determining that a bona fide employment contract is in place, that the individual on the payroll matches the personnel file, that the individual does exist and that attendance records are presented to support the payroll. The tests do not extend to the verification of performance of duties.

Monitoring of Payroll.

The approach to monitoring expenditures for payroll and O&M is slightly different based on the risks associated with the expenditures. The work of the Monitoring Agent, from the outset, considered for

² In the absence of a centralized nominal roll, actual total headcount is only determined through a database kept in MoF by the ARTF Monitoring Agent on the basis of summary reports of monthly payrolls in the provinces and detail reports provided by the Kabul ministries which accompany the payroll payment requests.

example the additional controls applied to payroll: centralized control of authorized posts, centralized head count data base and the verified payroll program. These arrangements contributed to a relatively lower level of ineligible expenditures detected in payroll payments. The Monitoring Agent reviews payroll expenditures through site visits and from the Ministry of Finance through statistical samples drawn from the expenditures for the whole year.

For O&M, however, the amount of ineligible expenditures has been much higher; these represent a higher relative risk due to the high risk environment in which the Government of Afghanistan operates and the absence of the extraordinary controls applied to payroll. The risk-based approach of the fiduciary oversight is designed to reduce the possibility of ineligible expenditures being funded through the “unmonitored” part of expenditures, though it does not eliminate the possibility.

The Monitoring Agent’s coverage and the ineligibility percentages should also be viewed in relation to the relative weight of payroll and O&M in total ARTF recurrent expenditures. In the last two years (SY1384 and 85) payroll approximated 71% of total uses and it reported ineligibility of 7.5% for SY1385, primarily arising from late reporting or exceeding head counts caps. These results provide a high level of confidence in propriety of uses.

Expanded coverage of payroll tests by the Monitoring Agent on provincial payroll in 1384 indicated a low level of error both for central ministries and provinces. This led to assigning more monitoring of O&M where more ineligibility was occurring and where individual transactions are of greater value. As such in 1385 payroll site visits were conducted in just the 4 largest provinces of the green zone (safest) provinces. (See Annex 2). Extensive payroll site visits by the Monitoring Agent are not necessarily “productive” in the sense that the payrolls are so disbursed over each province, continue to have a low rate of ineligibility and are of such low value individually that it is not possible to conduct tests of any significant share of the total transactions.

Evolution of Monitoring of Provincial Payrolls

The ARTF RC fiduciary framework is based on continuous risk assessment and therefore adjusts as new information arises and as circumstances of the control environment change, such as the deteriorating security situation in the provinces. The other major change is the expansion of the VPP program. As explained above, all critical payroll risks are addressed by the implementation of the VPP which provides robust formal controls over payroll. The MoEd, which employs 75% of civil servants in the provinces, is committed to an accelerated implementation of the VPP to a minimum of 30,000 in 1387 and 50,000 in 1388. Given the significance of MoEd in the total provincial payroll costs this expansion would significantly mitigate current risk and reduce the need for specific transaction monitoring.

In response then to the new information and changing circumstance, the MA will:

- update the risk assessment of provincial payrolls by testing the 1386 payroll in all 17 green zone provinces which together total 60% of the provincial payrolls
- make use of MoF Internal Audit for the 1386 payroll tests in the red zone provinces.
- plan site visits for payroll testing of 1387 in response to the expansion of the VPP, specifically:
 - substantiate that the VPP was in place, assess the implementation and periodically verify that the payroll is processed through the VPP.
 - monitor in the remaining provinces the basis of the 1386 provincial monitoring results

ANNEX 1

Oversight of Provincial Payroll

Staffing caps and allotments. Controls over all payroll are based first on the staffing establishments (Tashkeels) which are proposed by the Ministries and approved by the Office of Administrative Affairs (OAA) during the annual budget process. The tashkeel provides the organizational chart for the ministry, detailing staffing positions and levels. In the absence of a nominal roll, actual headcount can be determined through a database kept by the Monitoring Agent on the basis of summary reports of monthly payrolls in the provinces and detail provided by the Kabul ministries. The other component needed by ministries and departments for processing payrolls is the takhsis (the salary allotment for the budgetary units) this ensures that payroll costs firstly relate to the approved staff levels and secondly that the spending is kept within this limit.

Staffing, personnel records, and pay scales. The Independent Administrative Reform and Civil Service Commission is responsible for oversight of appointments and promotions (for positions at grade 2 and above), civil service management, and administrative reform. Historically, the line ministries held personnel files for all staff, but these are no longer maintained, and nor do the ministries have information on the position and grade for all hiring. Hence the payroll arises from the staffing, personnel records and attendance records maintained by the individual budgetary units and are found to be complete and in good order.

Every public employee has a personnel grade. Civil servant wage rates and pay policy are established centrally for all public employees in Afghanistan. Two base pay scales – one for contract staff and another for permanent staff – apply equally everywhere in Afghanistan. There are separate pay scales, however, for teachers, the army, and police. In addition, several new programs allow higher pay rates, based on a clear vision of core responsibilities, structural reorganization, and merit-based appointments.

Payroll processing. Payrolls are usually prepared manually by budgetary units. They may also be prepared from stand-alone automated payroll systems, for instance in the MoF (MS-Access database). Central authorities do not impose any standard for this processing or establish any minimum requirement to link to personnel records. The request for funds to pay payrolls follows the procedure used for any payment, with the payroll sheet used as support. After the requisite authorizations in the budgetary unit, including the MoF's controllers within the budgetary unit or in the Mustoufiat, the requests are reviewed by the MoF in Kabul or the Mustoufiats.³ This review is limited to matching the payroll sheet to the request for funds, viewing the allotment ceiling for salary and for positions (Tashkeel), but does not extend necessarily to underlying records. Except for those covered by the various stages of the VPP (see below), payment of payroll depends on a bonded trustee who receives a check for the payroll amount for a budgetary unit, withdraws cash from the bank, and makes the settlement with each staff member who evidences receipt by signing the payroll sheet.

Verified Payroll Program (VPP). The MoF is leading an initiative to verify the national payroll. The program aims to cover all civil servants in Kabul ministries and agencies (200,000) and comprises three

³ In FY 2002/03 and FY 2003/04, this control was centralized in Kabul, which created delays in payroll processing, as provincial representatives had to travel to Kabul every month, without improving the controls, as the central Treasury had no capacity to review the paperwork in detail.

stages: issuance individual salary payments monitored by Treasury staff, salary payment from the list in DAB (requiring an ID), and deposit of salary to commercial bank account of Government employees. Individual salary payment implies witnessing the payroll distribution by a team comprising the budget unit representative, a representative of the DAB Bank staff, and a representative of the MoF. To date, 13 ministries have been processed through the first stage, and individual salary payments are being processed for 90,000 employees including 26,000 in provinces. Until recently the rate of transition to more advance stages was constrained by the limited banking services available for direct deposit but solutions are now being identified.

Monitoring. The payroll cost for the non-security sector of the recurrent budget is subject to review by the Monitoring Agent. This review relates the payroll sheet entry back to the accounting entries and to personnel and attendance records. It also includes witnessing individuals who are in the payroll records. The record of compliance is very high (92.5%); monitoring from 1381 through 1385 and even in the conflict affected provinces found that internal control on payroll procedures is strong. The MA's sample out of the three million annual payroll transactions is, however, is too small to provide conclusive assurance of the non-existence of "ghosts" on the payroll. While the existence of a bona fide contract with an actual staff member is verified as well as their attendance in the attendance records, the work does not extend to determine if actual work is being done by those who are paid.

External Audit. The Auditor General (CAO) reviews the payroll for the ARTF RC audit with tests similar to the MA. This review was done with the assistance of Deloitte of India in 1383, 1384 and 1385 but their in conflict affected provinces is restricted.

Nevertheless, the CAO visits the provinces and reviews payroll as part of his regulatory audits. His report on 1385 and 1386 work indicates that in 1386 the work program for provinces had 580 operating units of Ministries in the provinces. Of those 91 units in 9 provinces were not able to be visited due to security. The rest however were visited and salaries were checked in all these units as part of the audit scopes. However the scope for salaries is not able to cover the regions, districts and operations in villages where payrolls are prepared as the CAO does not have the resources to audit at those lower levels.

It is at these levels in ministries that unsubstantiated payroll costs may occur however CAO does not have significant audit findings on salaries in 1386 or 1385.

Internal Audit. Most line ministries have internal audit departments established and operating. The MoF IA Dept is working to a high standard and in the annual plan will cover provincial payrolls via their visits to the Moustoufiats. In 1386 only the Kabul Moustoufiat was reviewed where payroll testing was limited.

Summary. Controls over payroll expense exist in aggregate through the tashkeel and the allotments. Personnel and payroll processing are decentralized which facilitates timely changes to personnel records although reconciliations between personnel records and the payrolls are done manually. The implementation of the verified payroll program has provided good assurance that payroll goes to bona fide employees but this program has not yet expanded its coverage sufficiently in the provinces. Similarly, the ARTF Monitoring and annual ARTF audit provides oversight for the non-uniformed payroll costs. Lastly, this work is complemented by the regulatory audits of the CAO and the work of the internal auditors.