

Restructuring CAO, Afghanistan
&
Strategy to Improve Audit Processes

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for

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Section A : Introduction
(incl. Conclusions & Recommendations)

INTRODUCTION

This study has been undertaken in context of experiences gained by the Audit Agent in the workings with the CAO staff and a number of other studies undertaken earlier. Purpose of the study can be summarised in a broad sense to make CAO office more effective.

The scope of this study can be categorised into following two broad areas:

- To study CAO's present structure and suggest revised structure and organisational changes, including a revised staffing structure to provide a flexible base on which CAO can operate, and
- To identify and agree with senior CAO management, an implementation strategy, to modernise their working practices and procedures, in the context of current needs and to implement the initial phase to the extent possible.

This report examines the needs of an SAI in the broad areas as elucidated in its strategic Development Plan. It examines these in the context of present day position, suggests improvements, or where the same is not feasible at this juncture, at least identifies these as issues which require attention in future.

CAO Organisation Structure is examined, from an overall context, and changes are suggested, along with rationale, to give push to institutional mechanisms within the CAO office, which help achieve the overall objectives as envisaged in the Strategic Development Plan. Another important area, that the TOR required was to provide an Implementation Strategy for implementing Audit Planning Manual.

METHODOLOGY

To undertake the above tasks, the studies undertaken by the Audit Agent Bank reviewing different aspects of CAO working were reviewed. Prominent among these are,

- Strategic Development Plan (Sept 2004 to Sept 2009) as developed by CAO with the active assistance of the Audit Agent,
- Audit Planning Manual for CAO office
- Report on workings and methodologies of CAO audit groups
- PKF quarterly reports
- Auditing Standards issued by INTOSAI
- European Implementing Guidelines for INTOSAI Auditing standards

Further a number of studies undertaken to review workings of SAIs of other countries were also reviewed. Such extensive study of documents helped in understanding the type of standards and needs of a SAI office. The documents considered have been acknowledged.

To ensure that this study does not remain an academic exercise, in-depth discussions were held with almost all the directors of the CAO office, to understand their present level of working, identify the problems that they are facing and to find ways, which help build on these processes and procedures and develop CAO structure in a more organic way, rather than grafting new structures which may not be sustainable.

A final discussion was held in a meeting with all CAO Directors, where the conclusions reached were discussed and the directors' views were taken on suitability of implementing the same. Their views have been considered while framing the final recommendations.

Discussions were also held with World Bank officials, who are not only funding the present Technical Assistant programme but have also undertaken studies in this area, to take their views into account while preparing this report.

A few of the documents used by the CAO staff were got translated in English and studied as well as discussed with the concerned persons. All this helped in understanding the present methodologies of the CAO office.

STRUCTURE OF THE REPORT

The report has been basically structured in four sections.

- This Section A, is the introductory section, covering scope, methodology, including conclusions and recommendations.
- Section B, the largest section, examines the Strategic Development Plan in some detail, giving current status, as ultimately this Plan is the basis for all analysis and conclusions.
- Section C provides Implementation Strategy for implementing the Audit Planning Manual.
- Section D covers the analysis and recommendations for Organisational Structure of CAO, its rationale and Terms of Reference for persons heading new Directorates.

MAJOR CONCLUSIONS AND RECOMMENDATIONS

The conclusions and recommendations covered in this summary are of immediate importance and hence need to be considered for implementation.

Restructuring CAO

Organisation Structure

CAO office at present is headed by an Auditor General. It has 9 individual directorates, headed by individual Directors. CAO also has two Deputy AGs, who undertake works as

assigned to them by AG. These directorates are organised on the basis of functional responsibilities, i.e. providing audit support for different type of organisations. Presently there are no inhouse capacity-building directorates or any other departments. Whatever capacity building is offered, it is done through, Technical Assistance of Audit Agent or through cooperation with Indian SAI. However there are no inhouse responsibilities on anyone to plan and oversee such a function, except that Planning & Analysis Directorate undertakes certain coordination functions of the Training with Indian CAG.

Although Auditor General does get involved in a large number of capacity building measures, however for an SAI there are a number of aspects, of capacity building, such as research, looking into working standards of CAO as a whole and finding ways to improving them, legal aspects, providing training at different levels of the staff and monitoring the same. It is obvious that AG, whose main task is to provide leadership and take decisions in regard to various CAO responsibilities, cannot, on its own, undertake all such functions and manage them. It is expected that institutional mechanisms need to be in place within CAO to manage these responsibilities in an effective manner.

Accordingly, it is recommended that CAO has two wings, an Audit Operations Wing and an Research and Human Resources Development Wing. The two wings should be managed by two Deputy Auditor Generals.

The Research and Human Resources Development Wing should have two Directorates, one should be called Research and Legal Directorate and would be responsible for studying the present practices and procedures of CAO to improve them to comply with International Auditing standards, studying different types of audits that CAO should be undertaking and developing methodologies on how to provide the same. It would also have a Legal cell, its main responsibilities would be to help Govt. of Afghanistan develop laws in the field of audit and bring them to the international standards and provide support to Planning & Analysis Directorate to decide on actions to be taken on audit findings which have legal implications.

The other Directorate under the Research & HRD wing should be called Education & Training. Its main responsibility would be to work with Audit Agent and other international bodies like SAI to develop and training plans for CAO's staff. Overall responsibility of this Division will be to develop capacities of CAO staff to an international level. It should also help govt. of Afghanistan in developing overall Financial Management capacities in Afghanistan. This is further described in detail below.

No major changes are suggested under the Audit Operations Wing of the CAO, as it will constitute of the present directorates which are functioning relatively smoothly and hence should not be tinkered with too much. However following two changes are suggested to improve the overall audit potential.

CAO office is undertaking audit of a number of Donor supported projects, however presently these are being done mainly by the Audit Agent, who takes some support of

CAO staff, however, the technical know-how of undertaking such audits does not get transferred to the CAO staff, as presently the Audit Agent has to work with different CAO audit staff, with no single person from CAO taking overall responsibility of having these techniques transferred to CAO. It would be far more appropriate for the Audit Agent to work with one Directorate, who the Audit Agent would be responsible to train such techniques within a specified time. Present Directorate of NGOs, which is responsible for undertaking audits of NGOs, who are supported by donors, could be such a Directorate, which could undertake such audits. The methodology of audits to be undertaken for donor projects being implemented by NGOs will be quite similar to the Donor Funded projects being implemented by the Govt., often with the help of NGOs. Hence it is recommended that Directorate of NGO's scope be made wider to include Donor Supported projects, or the Directorate could be called Directorate of Donor Supported Projects.

It is also recommended that CAO should have regional offices, presently a large amount of CAO staff time and manpower is spent travelling to different provinces in Afghanistan. This also creates a number of logistic problems. CAO has already applied for having five Regional Offices, this is a valid request. This study also finds justification for such a request.

Progress over implementation of Auditing Standards needs strengthening

As mentioned above, presently there is no inhouse committee or body, which is ensuring how INTOSAI standards will be implemented at the CAO office. Till the time changes as mentioned above are implemented, CAO should formulate a core committee which should work with the Audit Agent to improve and internalise the international Auditing standards.

Acceptable Accounting Standards

All financial statements should be prepared on the basis of acceptable accounting standards. Presently there are no standards, which different institutions, particularly the Govt. of Afghanistan needs to follow. Most ministries or even entities do not prepare financial statements. CAO office should work with Ministry of Finance to set-up certain minimum level of acceptable accounting standards to be followed. The committee as recommended above could also help in this regard.

Review of Internal Audit Depts. at different ministries

Presently only around 14 ministries have internal audit dept. There is a proposal by the Ministry of Finance to enhance the scope of the internal audit in a major way. The Directorate of Internal Audits at CAO undertakes review of different internal audit depts. that are operating in different ministries. Generally purpose of such a review is to provide external auditor with effectiveness of internal audit function, however it has been observed that the reports prepared by this Directorate are not considered by the audit group which undertakes the external audits. The directors during a debriefing meeting held by the consultant at the end of the study agreed to provide the same to the audit groups. It is recommended that a copy of the report be provided from FY 1384 to the

external audit groups which will be responsible for undertaking audit of the entity reviewed by the Directorate of Internal Audits.

There is also a need to review the process of the Directorate of the Internal Audit group. This should be undertaken by the Audit Agent during its next contract.

CAO office should develop a comprehensive policy of skills upgradation

Skill upgradation of CAO staff is the major need of the hour. To promote this among its staff members, CAO should develop a comprehensive policy, linking incentives and promotions with acquiring of new level of skills among its staff members.

Complete Skill Development Plan

Under new contract, the Audit Agent should be requested to provide a complete plan for capacity building of CAO staff. The plan should indicate targets, with milestones to be achieved during the tenure of the contract.

Need to develop an autonomous body in Afghanistan

Considering lack of Financial Management skills in Afghanistan, there is a need to develop an agency on the lines of an Accounting Board or an Institute of Chartered Accountants, which can fill the void to provide education and training in the area of auditing and Financial Management in general. Although such a function is normally not associated with an SAI, however considering the conditions of Afghanistan, and since CAO is the only lead organisation, with some experience in such a field, it should coordinate efforts in this direction with Ministry of Finance.

Implementation of Audit Planning Manual

Planning & Analysis to further improve its procedures

During FY 1383, Planning & Analysis Directorate undertook a more flexible approach in its Planning, which has resulted in approx. 50% more audits being undertaken compared to the previous year. It is recommended that the directorate needs to continue this approach and further improve it by prioritising its audits.

This can be done through a structured risk analysis while making its annual plans. However as present the data for this risk analysis is not fully available, the annual plan for FY 1384 will be based on a limited risk analysis. However during current year, the Planning Division will take steps to obtain such data, so that from next year the annual plan will be based on a proper risk analysis, after considering different risk factors, such as expenditure allocated, revenues, previous year's audit experience, etc. In this regard Extracts of a revised Planning Manual, alongwith certain formats are attached with this report.

A number of meetings were held with the Director of Planning & Analysis, to help him implant the risk analysis procedures.

Improving Audit procedures

Gap Analysis Study

To further improve audit processes and procedures in the audits undertaken by CAO, the Audit Agent has suggested a study be undertaken with the Audit Groups. This study is being termed as Gap Analysis study and is aimed at identifying gaps between the working procedures of the CAO audit groups and as required under INTOSAI standards. The study is being undertaken by a staff member of PKF, UAE. The consultant has worked closely with the PKF personnel. The study is not complete as yet, however the initial findings of this study indicate following main gaps which need to be worked upon by the PKF Training to be undertaken during Jan'05.

- No Permanent Note Record being maintained by the Audit Directorates
- No evidence of pre-audit analysis being undertaken
- Preparing specific audit programs
- No formal determination of materiality limit
- No evidence to suggest if samples being selected are representative of population
- Documentation of audit evidence and review undertaken by the seniors

Training to be more interactive and practical

The Audit Agent has planned a Training to be conducted to improve the above procedures. The Training needs to be planned in a manner that it is practical. While clarifying the rationale of these processes, it needs to focus on providing formats, suitable to CAO. A coordinator from CAO side should be provided to the Trainer. The trainer should develop formats in close coordination with the CAO, so that formats can be easily assimilated with CAO's workings. The focus during the training should be to implement these formats. The trainer should give practical exercises, wherever feasible, particularly for developing audit programs. The delegates should be divided into groups, with requirement to make presentation of their exercises.

Implementation of above procedures to be undertaken in a phased manner

The above procedures should be undertaken in a phased manner, starting with certain identified audits. Initial audits in which this exercise is to be undertaken will be called Pilot Audits. Subsequently based on these pilot audits, the processes will be implemented in other audits too. During the debriefing meeting held with the Directors, it was agreed that Control & Monitoring Directorate will prepare a plan for this and would monitor the implementation process. The Trainer needs to work with the concerned Directorate to ensure that such a plan is prepared and the Control & Monitoring Directorate is clear on how the plans need to be implemented.

Role of Control & Monitoring Directorate

As can be seen from above, Control & Monitoring Directorate has a very important role to play in implementation of above processes. This is limited not only to the preparing of Plan, but subsequently to ensure that various Audit Groups are implementing this process. Accordingly the Control & Monitoring Directorate should modify its reporting format, which it uses presently, to identify if the Audit Groups are complying with the procedures as identified during the Gap Analysis Study and using the necessary formats as prescribed during the Training.

It is recommended that the Trainer should work with the Director of the concerned Directorate to help modify this format.

Strategic Development Plan
and
Current Status of CAO

INTRODUCTION

To study and comment upon organisation structure of CAO office and its working, it is important to understand the needs of an SAI, as well as present efforts made by CAO in this regard. Recently CAO has finalised its Strategic Development Plan. Main areas of this Strategic Development Plan are depicted in the chart below.



Each of these areas are further discussed below, identifying requirements of an SAI, present status of CAO, and future way forward for CAO.

LEGAL FRAMEWORK

An SAI should ensure that state audit legislation is in line with Lima Declaration of Auditing precepts. These cover many areas including,

- Requirement for independence of the SAI and its staff, which needs to be guarded by the constitution and legislation and protected by the judiciary,
- Independence includes being free from influence by audited organisations and provided with adequate resources.
- The mandate of the SAI should cover all public financial operations.

- The relationship of SAI with the legislature, which should be laid down in the constitution, this should include that SAI will be empowered and required to report annually to the legislature (or other public body).
- Mechanisms should be in place where the SAI shall also be empowered and required by the Constitution to report annually and independently to Parliament or other competent public body on its findings. The report shall also be published.
- SAI should have complete operational independence to conduct its operations without interference from any governmental institution. It should not require permission from any organisation to carry out its work. As a part of this operational independence, the SAI should have right to obtain and information and examine any document that it requires, and to interview any individual it deems necessary. This wide power may be constrained by individual rights, but otherwise it should be unfettered.

Issues requiring consideration

Many of the above already are consistent with present CAO position, however some issues, such as independence of audit office both in terms of appointment as well as budgetary resources, etc. to be included in constitution, need to be worked upon and the legislature needs to be encouraged to remove these inconsistencies.

Further presently a new Audit Law is under preparation. It is not within the purview of this study, to look into these aspects, albeit sufficient to say, that the proposed legislation should be examined in detail to ensure that these provide a proper framework for the CAO office to function in the manner identified above.

Since presently no parliament is in place, hence CAO office provides its report to the President. However there is a need to further evolve mechanisms in this area, particularly to ensure that reports issued by CAO office are available in public domain, to ensure public accountability.

AUDITING STANDARDS

An SAI needs to adopt auditing standards for ensuring an internationally acceptable level of auditing. INTOSAI is the main international body which sets the international auditing standards for the public sector. In addition International Federation of Accountants (IFAC) issues a number of international auditing standards for financial audits, however these are mainly developed for the private sector. Though there are plans for IFAC and INTOSAI to work in a collaborative manner, however INTOSAI is to maintain responsibility over standards for performance, internal control and compliance audits and reviews.

The auditing standards issued by INTOSAI can be categorised into following four main categories.

Basic Principles : These principles identify the key concepts which contribute to better governmental accountability. These principles require that

- INTOSAI standards are followed,
- within the SAI their should be adequate information, control, evaluation and reporting systems,
- there should be acceptable accounting standards in use for financial reporting and disclosure,
- SAI comply with the auditing standards and exercise their judgement in their application of this compliance, and
- SAI have the mandate to undertake all audits and receive the cooperation of audited entities.

General Standards : There are basically two types of general standards, one for the Govt. Auditing and the other relating to Ethical standards.

The auditing standards specify that SAI should adopt policies and procedures to recruit, develop, and supervise appropriately qualified personnel, to allocate the necessary personnel to audit tasks, and to review internal standards and procedures.

The ethical standards specify that the auditor and SAI must be independent, avoid conflict of interest, possess required competence, and exercise due care and concern in complying with the auditing standards.

Field Standards : These are detailed standards for conducting, managing, communicating and reporting on audit work. These fall into six areas. These are

- Planning,
- Supervision and review,
- Study and evaluation of internal controls,
- Compliance with applicable Laws and Regulations,
- Adequate audit evidence, and
- Compliance of Financial statements with acceptable auditing standards.

Reporting Standards : These standards assist the auditor in forming an opinion or preparing a report. There are two categories of reporting standards. One standard deals with written opinions and reports, while the other deals with requirement to identify actions to be taken and disclosures to be made in relation to fraudulent practices and serious irregularities discovered during audits.

Issues requiring consideration

Afghan CAO office is a member of INTOSAI, and plans to use the INTOSAI standards as its benchmark for all its working procedures, etc. However at present there is no

regulation which officially promulgates that CAO office will be using these standards. Further, presently the CAO office does not seem to have any institutional mechanism at present, to work on proper implementation of these standards.

The CAO office also needs to work in collaboration with Ministry of Finance to discuss and finalise acceptable accounting standards for financial reporting and disclosure to be used by the Government.

AUDIT DEVELOPMENT

Traditionally an SAI's scope of audit was limited to a narrow aspect of government's functioning, i.e. transaction audits. As the national and local governments have generally expanded significantly, with the quantitative size and variety of the Governments spending, so has the scope of the audits. However increasingly the SAIs are being called upon to provide not only the financial accountability but also much broader scope, the management accountability and program accountability. With most recent developments, some SAIs have also started looking into the underlying assumptions of the govt. budget.

There are basically four types of audit which, at present juncture, an SAI generally can perform:

Compliance Audit

This audit generally is audit of financial transactions that an organisation has undertaken. The audit requires to ensure if these are properly recorded, that public money has been properly accounted for, if any procurement undertaken has been done as per the regulations and that all legal obligations have been complied with.

Compliance audit reports are typically lengthy, as these will detail all type of failings identified by the auditors. Government audits traditionally focus on compliance audits, more so in the South Asia region.

Certification Audit

Under this audit, an auditor normally would express an opinion on the financial statements (mainly Balance sheets and statements of revenues and expenses) of an organisation. The opinion will be in terms of reliability (commonly expressed as true and fair) of the financial statements.

Performance Audit

This is also called as Value for Money audit or the Program audit. In fact it can be said that this is the first paradigm shift in the basic structure of in the history of public auditing. Such areas in Govt. auditing are very different from those in the corporate sector. In Govt. audits, the scope of financial auditing includes audit areas other than the audit of accounts.

The Performance audit includes the evaluation of 'three Es', i.e. economy, efficiency and effectiveness. However the Performance audit of a program has even broader objective, where the auditor needs to examine and comment upon achieving of objectives as initially set out, and the 'three Es' can be said as tools which will help in measuring the performance of the results of a program vis-à-vis objectives. Most countries at present undertake such audits.

Review of Budgetary Assumptions

Certain recent developments, have taken place where some SAIs have been asked to review the assumptions underlying the government budget, mainly relating to resource forecasts and forecasts of the cost of various programs. There has been some criticism of this audit function on the ground that it may lead to commenting upon the policy decisions of a Government's resource allocation. However as long as the auditor restricts its comments upon the validity of assumptions made by the Government, it is a reasonable extension of SAI's scope.

Issues requiring consideration

As expected CAO office has mainly been performing Compliance audits, one reason for this is also that most organisations do not submit financial statements, which require an opinion. Although with the technical assistance CAO office has undertaken a number of audits, expressing opinions, mainly on World Bank Grants, etc. However internalisation of such a technique still needs to go a long way. CAO office needs to pay special attention in this area, as more and more Grant audits are likely to take place. It may be noted that CAO office also undertakes audit of a number of public enterprises, where it is important for the organisations to identify the status of their profitability as well as status of their financial position, therefore as a next step in its development, CAO office should take steps to enable itself in providing certification audits for such grants / enterprises.

CAO office has not undertaken any performance audits in a methodical manner, though sometimes comments are made on individual transactions from the point of view of economy and efficiency.

Who should undertake audits

As expected generally SAIs have their own staff, who normally undertake most of the audits, however, in the countries where SAIs, face severe staff constraints compared to volume of work, such SAIs appoint private audit firms. The use of such audit firms is generally restricted to public enterprises, whose nature of operations is much closer to commercial operations in nature, hence most suitable to the private audit firms experience for undertaking such audits. In India, for example, private audit firms are appointed by Indian CAG to undertake audit of all public undertaking and nationalised banks, in which Government has majority stake.

Issues requiring consideration

At present all audits are undertaken by CAO staff. The grant audits are being undertaken by CAO mainly with the assistance of Technical Assistance provided by the Audit Agent.

The scope of work at CAO office is increasing as more and more grants are being sanctioned by different donors. Purpose of CAO office undertaking grant audits with the support of Technical assistance, is to help build capacities in the CAO staff. However if the volume increases to an extent that CAO office is not able to cope with its available resources, then it should consider other options.

Internal Audit

Internal audit is an essential part of internal control mechanism. While the scope of external audit is determined through legislation, generally its purpose is to provide an accountability mechanism for utilisation of funds, the scope of internal audit is determined by the needs of the head of organisation. Sometimes this could be limited, while other times it could be quite wide.

Though there is no doubt that an effective internal audit service can greatly reduce the workload of the SAI. However internal audit is always subject to the direction of the head of the organisation and can never be truly independent. Accordingly, no matter how good the level of internal audit coverage, the key role in accountability will always rest with the SAI and its external audit service.

Current Status

In Afghanistan, presently there are following structures of internal audit in place.

- Internal audit depts. are in place in approx. 14 ministries, including Ministry of Finance.
- CAO office has a Directorate of Internal audit which reviews the work of these internal audit depts. The directorate is manned by around 15 persons with an independent Director.
- Presently Ministry of Finance is in the process of establishing an internal audit dept. the Ministry of Finance, who will undertake audits in different ministries.

Issues requiring consideration

It may be noted that the methodology of Internal audit departments in different ministries is similar to that the CAO office uses for its external audit, i.e. instead of looking for system compliance, the tests are designed to undertake transactions audit.

It was observed that normally reports prepared by the internal audit dept. are not considered by the Audit Group undertaking the annual audit of that dept. Considering this report is prepared by one of the directorates of CAO, the report is independent of the concerned ministries and would also consider issues from the perspective of an external auditor, hence it would be a very useful report for the audit group which undertakes external audit of the concerned ministry. Hence a copy of this report should be made available to the audit group which is likely to take external audit of the concerned ministry.

During the discussions with the CAO Directors, it was agreed that the copy of the report would be made available to the concerned Directorate, who will make it available to the Audit Group to undertake the audit of concerned entity.

AUDIT PROCEDURES or Working Methodology

An SAI should adopt approved work programmes and plans that clearly set out the audit objectives, auditing methods to be used, responsibilities, time budgets, expertise required, etc. All audit tests, findings and observations should be supported with appropriate clear and concise documentation. Audit procedures need to always be adopted to be in sync with the technological advances being made by the auditee institutions.

Most fundamental of the audit procedures, is selection of a sample. It is important that sample selection techniques are applied in a manner that these provide samples which are representative of the population, and are updated with latest techniques available. Many of the SAIs currently use, Computer Assisted Audit Techniques for the data analysis and the sample selection. Further it is one of the requirements of a good audit that all audits should be supported with proper working papers.

Issues requiring consideration

Presently at CAO, traditional techniques of sample selection, is mainly based on Judgement sampling. Though it is possible to identify a representative sample based on such techniques, however this requires clear understanding of the needs of sample selection.

These aspects are further discussed in the section of Implementation Strategy, where present practices of audit procedures and methodology are further covered in detail.

Managing quality in audits

The objective of an SAI is not simply to carry out audits in terms of its legislation, but to provide audit work and audit results that are of a consistently high quality. To achieve this, an SAI needs to develop a whole range of structure, processes and procedures that ensure that audit reports and other outputs of whatever kind, are of good quality.

Audit report is the end product of an audit process. Quality Control in this process provides reasonable assurance that the results of the audit, as contained in the audit report, are an accurate reflection, in all material respects, of the true conditions of the matters under consideration.

European Union under popularly known *Prague Recommendations* have stated that SAIs should ensure that human and financial resources are used in the most efficient way to secure the effective exercise of the mandate. To this end, an SAI management needs to develop and institute appropriate policies and measures to help guarantee that the SAI is

completely organised to deliver high-quality and effective audit work and reports. Since SAI cannot undertake objective review its own work, many countries opt to have a review done either by private consulting organisations or more often by an SAI from another country.

This is a major area of deliberation and development, suffice it may to state here that through quality planning and quality assurance, an SAI can achieve its objectives of providing reasonable assurance on all Govt. expenditures.

Issues requiring consideration

Present effort of CAO office is mainly directed towards ensuring basic compliance of its present audit procedures by various groups, as the name of the Directorate 'Control and Monitoring' suggests, that the function is mainly to monitor rather than improving overall quality through research and other methods. However even in its present limited role of Control and Monitoring, it can provide invaluable support to ensure that various new audit procedures being implemented at CAO are being complied with.

HUMAN RESOURCE DEVELOPMENT (Training)

An SAI's major assets are its people. These must be adequately competent, skilled and experienced to carry out their audit tasks and duties. Level of these competencies will depend upon the roles and seniority of the individuals. Competence will be developed through a combination of training and experience. Training generally is a combination of classroom and on the job training. Level of technical skills would normally expand with seniority. Directors will need specific competencies in audit planning, management and review of conclusions and reporting. Even Auditor General and his deputies would require training according to their role.

Normally it may be a good idea to have some form of certification within the training to identify the level of competencies attained by individual persons. Such a certification process can combine work assessment, course attendance and formal examinations. To motivate staff to obtain higher degree of skills in their work, certification could also have a weightage in the promotion policy.

To instil a sense of pride and professionalism towards the work that the SAI employees undertake, an SAI could develop and promulgate to its staff a Code of Professional Ethics, which is applicable to institution itself and its employees. Normally a code of Ethics include issues relating to Trust, Confidentiality, Credibility, Integrity, Independence, Objectivity, Impartiality, Conflicts of Interest, Professional Secrecy, Competence and Professional Development. One way of enhancing the impact of such a Code of Ethics is to have individual employees sign such a declaration that commits them to comply with the Code of Ethics.

Issues requiring consideration

One of the requirements of INTOSAI standards is that an SAI should recruit personnel of suitable qualifications, skills, competence and aptitude for audit work. Although many of the CAO's staff have held significant experience in undertaking audits, however due to the past long conflict situation, it is quite difficult to find persons of appropriate qualification. Also the available CAO staff have started taking audit assignments only in last couple of years, and are outdated of most developments which have taken place in last two and half decade.

To overcome these obstacles, CAO employees would need extensive training (both formal and on-the-job training). The Audit Agent has provided a large number of training over its Technical Assistance programme. Considering the importance of this area, while negotiating a new contract, CAO needs to ensure that the future contract adequately considers this aspect. As an initial step, the CAO office should request, that under the new contract, there should be a provision to prepare a complete plan for capacity building of CAO staff. The plan should indicate its targets, with milestones during the tenure of the new contract.

CAO should consider developing a comprehensive policy of skill upgradation of its staff, providing incentives to its staff, wherever possible linking it with promotions, for reaching new levels of skills, which combines, training with promotion aspects.

Education in the area of Auditing & Financial Management

There are not sufficient skills available in Afghanistan for fulfilling the needs of proper Financial Management, including accounting and auditing. At present there are no bodies, autonomous or otherwise, which provide education in these fields. Considering there are huge requirements in the country, there is a need to develop such a body, maybe on the lines of autonomous bodies such as an Accounting Board or an Institute of Chartered Accountants in India or Pakistan.

Though this is not an area in which normally an SAI would be involved in, however considering special circumstances of Afghanistan, where due to last almost three decades of conflict, opportunities for education have been minimal, and considering CAO is the lead organisation in the field of audit, it needs to coordinate with Ministry of Finance to have such a body instituted in Afghanistan. This will go a long way in developing Financial Management skills in the country.

INFRASTRUCTURE

A respectful workplace should be developed where auditors have proper working conditions and an appropriate environment to work in. Such a conducive environment would help the development of skilled, motivated and productive staff, who, would be more amenable to fulfilling the mission of the SAI.

Apart from the working environment, other major aspects to be considered are access to computers, easy communication, including phone, internet, inter-com, etc., easy transport facilities to travel to various client locations.

Issues requiring consideration

Normally such conditions are generally assumed in most SAIs, however in case of Afghanistan this is one of the biggest impediments. For example, staff members at many of the international SAIs have wide access to computers and even Computer Assisted Audit Techniques in undertaking the audit processes. However due to extremely poor level of infrastructure, both in terms of availability of computers as well as poor availability of electricity, such facilities are not so easily available to CAO staff. However some initial efforts made have borne some fruits and most Directorates use computers. However this use is limited to correspondence, planning, report-writing, etc. Though this is still at initial stages, however, at some time in future there will be a need to determine IT policy for the CAO, including establishing of a separate IT cell.

Similarly space is a major constraint for present set-up in CAO office. The present building being used is quite old and dilapidated and is insufficient to accommodate all staff. There is no proper place for holding training for large number of staff members. CAO office though have made a number of efforts to acquire a better premises, however till a donor comes forward to support such a project, CAO has to manage with the available premises.

INTERNATIONAL RELATIONS

Developing international relations is an important aspect of a SAI's scope. Such an exercise provides opportunity for an SAI to cooperate in the areas that it is strong and also learns from other SAIs. Some SAIs also have active Training programme to be provided to SAIs from other countries. International cooperation also provides opportunity to participate in international seminars and conferences, to learn latest developments in the field of auditing and develop local expertise accordingly.

Afghanistan Auditor General has participated in such international seminars and conferences. He has visited his counterparts in UK and India. Presently there is a close cooperation agreement with Indian SAI. Based on this agreement a number of CAO personnel are being trained at Indian CAG office. Considering major needs in improving its present auditing standards and skills, CAO needs to develop more such contacts and cooperation agreements.

Two other major areas, which are important aspect, Planning and Organisation Structure are covered in separate sections of this report.

**Strategy for implementation
of
Audit Planning Manual**

PLANNING

This is another very important area to be considered while considering a development of an SAI. One of the constant issues that every SAI has to deal with is that it needs to provide audit assurances in more than areas and for more organisations than it has resources.

CAO is no different, it has to undertake a large number of audits. As per information available, during FY 1383 CAO needed to take up audits of 451 entities. These included 276 at different provincial levels while 175 at the central level, including a large number of public enterprises entities. In addition to the above, the project needs to provide audit assurances on a number of World Bank and other donor funded projects, as well as ARTF. CAO has a strength of around 170 approx. audit staff to undertake all these audits.

This is a common problem that all SAIs need to tackle and answer lies in careful undertaking of risk-analysis, so that an SAI can prioritise its audits in a manner that all high risk areas are audited and audit assurance provided.

Issues to be Considered

Till last year, the CAO used to allocate staff on a fixed period of three month basis for each audit. Since such a practice was rigid and not scientific at all, the Audit Agent had suggested changes for having a more flexible staff allocation. For the FY 1383 (FY 2004-05), the CAO allocated staff on a flexible basis. It has allowed CAO to immediately increase the number of audits that it covered during this FY. (A rough estimate indicates that CAO office has been able to increase its efficiency by more than 50% by using this approach). There has been some criticism from the audit staff of this approach, mainly on the grounds there was now less time to undertake the audits. However considering the improvement in overall efficiency of CAO, it is felt that it was a correct move on the part of CAO. However the Planning & Analysis needs to further improve this process.

Implementation of Audit Planning Manual

The Audit Agent developed an Audit Planning Manual for the use of CAO. The manual was translated and provided to CAO, however it was found that the Planning & Analysis Directorate was experiencing difficulties in implementation of this manual. During this study, the manual was discussed in detail with the concerned Director, who agreed that after certain changes are made the manual, it would be implemented. Accordingly changes have been made in the manual, and a revised copy of the manual has been provided to the CAO. A copy of the extracts of the revised manual is attached with this report for reference. (see Annexure II)

The main changes pertain to obtaining inputs from the audit group for each audit that is undertaken through a formal but brief one page report. This information will form the

basis of risk analysis. The Planning & Analysis Directorate will input this data into a spreadsheet, which is a list of all the entities for which audit-risk analysis needs to be undertaken. Based on certain criteria as explained in the manual, audit risk for each entity is determined, and risk level of each entity is determined. This can be the basis on which an annual plan can be prepared.

To keep the plan up to date for any unforeseen changes, this plan should be reviewed on quarterly basis.

The above basis will be much more scientific and would help prioritise the entities that need to be audited with limited resources and minimise risks that CAO office faces in deciding the entities that it needs to audit.

Gap Analysis Study

The foregoing is the Planning exercise for the CAO office's annual plan, the Audit Planning Manual also covers planning aspects for individual audit. The Audit Agent has planned a Training course to be undertaken during January / February'05. During planning for this training, the Audit Agent considered that Training should be need based. Accordingly another study has been organised. At present a large part of it has already been undertaken, purpose of the study has been to undertake a Gap Analysis, to identify major areas where CAO working still needs to be improved upon to comply with INTOSAI standards. During the discussions both with the Audit Agent as well as the CAO office directors, it was decided that this study should focus on current audit procedures and practices of CAO.

Accordingly a questionnaire was prepared on the basis of INTOSAI requirements. Interviews and discussions have been held with a sample of Audit Groups covering different types of audits, as well as interviews with Directors responsible for such audits.

Though study is still not complete, hence it would be inappropriate to reach conclusions, however the initial results indicate that some of the following areas appear rather weak in the present CAO working.

- Risk Analysis of individual audits
- Preparation, review and approval of audit programs
- Defining the materiality level
- Selection of sample
- Maintaining of structured working paper files

The above results are by no means final or complete, but indicative of the areas that need to be strengthened. Final report is expected shortly. Based on this report the forthcoming Training module will be formulated and is expected to provide specimen working paper formats, which need to be used in the audit.

This Training will need to be held in close coordination with Control and Monitoring Directorate, who will need to play a major role in ensuring that procedures as recommended through Gap Analysis Study are complied with by different Audit Groups.

Considering that this Training will suggest certain new procedures and working paper formats, it is important that the persons who are attending this Training are seniors, mainly Directors and Team Leaders.

Examining

CAO

Organisation Structure

PRESENT ORGANISATION STRUCTURE

The present organisation structure of CAO office is attached as Annexure I. This mainly revolves around its main forte that is to undertake audits. An SAI has to perform audits and this has to be its major tasks. Therefore having its structure revolve around such tasks is understandable.

However it also needs to build capacities of its workforce, undertake research to keep itself upto date with latest developments in the field of auditing, new auditing standards, pronouncements, etc. Hence it is vital that there are institutional mechanisms within the CAO Organisation structure which ensure the same. Accordingly two broad divisions are suggested one mainly for Audit Operations and other for Research & Human Resource Development. These are further discussed below.

Research & Human Resource Development Division

Audit Agent has undertaken a number of steps, for capacity building during its tenure of more than two years. However one of the problems that it has faced is internalisation of these capacity building mechanisms. Improving of IT and English language has made major strides as classes are held almost on a daily basis, certificates are issued. Thus Audit Agent has been able to institutionalise these arrangements. Most senior staff interviewed had good knowledge of Audit principles and a fair amount of knowledge of audit techniques.

In addition to the areas mentioned above, i.e. improvement in audit procedures and processes, there is a broader need for CAO office to strengthen a number of areas, such as:

- Capacity Building of its entire work force through a structured Training Program
- A research wing which helps to identifies latest audit standards that need to be complied with and identifies the ways in which these can be implemented within CAO
- Presently Afghanistan is in a nascent stage of developing a legal structure for its audit requirements, Research Division should have sufficient legal expertise to ensure that legal requirements of ensuring independent and accountable audit are well taken care of.
- One of the obligations of CAO office is to report any situations that it identifies, which need to be reported to Attorney General for further action. In such cases CAO office should have sufficient inhouse legal expertise to consider such findings and advise action to Auditor General.
- There are different types of audit which most SAIs undertake, presently CAO office mainly undertakes compliance audits and certain amount of certification audits with

assistance from Audit Agent. CAO office needs to develop methodologies to be able to undertake other type of audits.

- Maintaining international relations is an important task of a SAI, and CAO office needs to build relationships with a number of other SAIs.
- CAO office has recently started publishing an inhouse magazine for CAO staff. This is a good initiative and needs to be continued.

There is a need to have separate directorate to undertake such functions. Accordingly following new Directorates are suggested.

- Research, Legal and Audit Standards & Methodologies
- Education, Training, International Relations & Publications

Since the activities covered by these Directorates are quite distinct and different from the activities of conducting audits, these require constant leadership and guidance, both in strategic terms as well as providing directions to the two directorates, accordingly the two need to be headed by a Deputy Auditor General.

Terms of Reference

Research, Legal And Audit Standards & Methodologies

One of the challenges that the Audit Agent has faced, that despite undertaking Training and providing a number of working-paper formats in English as well as in Dari, the internalisation of these working paper formats has not taken place, as desired. One of the reasons for this is the weak institutional arrangement within CAO, which can take responsibility of such tasks.

Therefore, one of the responsibilities of the proposed directorate should be to improve audit practices & procedures within the CAO. In this regard, one of the first steps could be to implement working papers to be used during the audits by various Audit Groups.

This Directorate will be headed by a senior person who has extensive to good knowledge of international audit standards and audit developments in other countries. It is expected that such a person will initiate steps to harmonise and upgrade present audit practices of CAO to international level, in a phased manner.

Training & Education, International Relations & Publications

The Directorate will need to be headed by a person with experience in undertaking Training and capacity building. Such a person needs to work in close coordination with the Audit Agent for implementing its Training plan. The concerned person should be able to coordinate with organisations at international level to ensure relevant and practical capacity building of not only the CAO personnel, but CAO as an institute.

If in short-term it is not possible to find different persons for the two positions, one person can manage both the positions, however as the volume of work increases, there will be a need to take different persons for the two positions.

Audit Operations Division

This Division is already existing in the form of a number of Directorates. These have been organised on the lines of different types of audits, mainly from budgetary angle. Since these directorates are working quite well and there appear to be good amount of coordination in terms of sharing of staff, at this juncture no major suggestions are being made to change the present structure, except for following.

Directorate for audit of Donor Supported Projects

Presently the project has a Directorate for undertaking NGO projects. Till now no major audits have been undertaken under this Directorate, as CAO found information on NGOs was not forthcoming. It may also be noted that the NGOs use funds of donors, hence are accountable to these donor agencies, rather than to the Govt. Therefore till the donor agencies do not request CAO or require that the Govt. of Afghanistan takes these audits, audit of NGOs only, will not be a sustainable idea.

However CAO has undertaken a number of audits for World Bank (who require that CAO office undertakes such audits) as well other donors like UNDP (who requested CAO to undertake the audit with assistance of the Audit Agent). There are requests from other donors, further the Govt. has signed a number of agreements with several donors and in all probability will be doing more and more such grant agreements. Many of these grants have provision for providing audit by the Govt. of Afghanistan, hence CAO office is likely to be called upon to undertake more such audits.

In view of the above reasons, the present Directorate of NGOs may need to have a broader scope to cover all Donor Supported projects. Such audits require specific approach and skills, hence it would be appropriate to have such an independent directorate. Persons who will be required to work in such a Directorate should have exposure or adequate training towards international audit practices and Balance sheet audits, etc.

Regional Offices

Presently CAO office operates from Kabul, it needs to cover all provinces, both for provincial audits as well as many Public Enterprises audit. This requires that CAO staff need to travel frequently to different provinces. Logistically this places onerous responsibilities over CAO staff structure, as often time is spent in travelling, including during winter months. Hence having regional offices, at least in 5 different regions, will reduce the pressure on CAO office and improve the quality of audits as more time could be spent from such regional offices.

PRR

CAO office submitted its proposal to Administrative Reform and Civil Services Commission to bring 171 positions of CAO under PRR. The proposal has been accepted by the Commission. It is in the process of finalising certain procedural aspects before taking up the interviews for the posts of senior positions.

The two new proposed directorates would be headed by independent Directors. More details of such positions have been discussed under the relevant section of the report. These positions require certain special skills in latest audit developments as well as proficiency in English language. In case CAO is not able to find suitable positions through the present PRR mechanism, it may consider other instruments such as Expatriate Afghans, etc. available with ARTF.

ROLE OF CONTROL AND AUDIT OFFICE

During the consultant's interactions with various institutions in Afghanistan during last one and a half year, it has become quite apparent that the perception of CAO office's role at various govt. levels is all inclusive. This impression was further reinforced during a recent discussion when a senior CAO official stated that the Govt. of Afghanistan expects CAO office to perform three roles that of Control, Inspection and Audit. Obviously no one institution could fulfil all these roles as the objective behind the three roles is very different.

I believe, this perception has been generated mainly on account of lack of clarity of objectives of different roles and how best these could be performed. These roles are described as below.

Control is a function, which the Ministry of Finance, would like to ensure, so that all expenditure incurred at various levels of the Govt. is in accordance with rules and regulations and after obtaining necessary approvals and authorisations. These functions can be ensured only through proper internal control, which includes the function of internal audit.

Inspection is a function, which is expected to help in prevention as well as detection of corruption and frauds. Experience tells that this function largely can be detected through information that is provided by the employees themselves or by public at large. This is not so much dependent on internal controls, as often corruption takes place due to collusion among more than one person. India, for example, has a separate institution called Vigilance Commission for such responsibilities.

Purpose of audit function is to generate confidence among public at large and donors by providing accountability on the judicious use of public and donor funds. The auditors are expected to ensure that not only funds have been properly accounted but also that Govt. uses such accounting policies, which are generally acceptable. Such exercise requires special skills and knowledge.

One of the reasons, why traditionally in Afghanistan CAO office is expected to perform all these roles is that there are not such institutions with clearly earmarked duties and responsibilities. Therefore it is important for Govt of Afghanistan as well as CAO office take steps, which help develop institutions, such as internal audit and specialised institutions for identifying corruption and fraud.

List of annexures

1.	Proposed Organisation Structure Chart of CAO	Annexure I
2.	Extracts of Revised Audit Planning Manual	Annexure II