

FINAL MANAGEMENT LETTER

30 JUNE 2016

RECURRENT COST AND REFORM FINANCING PROJECT – PHASE II (P154875, TF0A0534)

IMPLEMENTED BY: FEDERAL GOVERNMENT OF SOMALIA (FGS), MINISTRY OF FINANCE

FINANCED BY: INTERNATIONAL DEVELOPMENT ASSOCIATION

FOR THE IMPLEMENTATION PERIOD 29 JUNE 2015 TO 31 DECEMBER 2015

PROJECT STATUS: ONGOING

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ABBREVIATION

EAFS	External Assistance Fiduciary Section
FGS	Federal Government of Somalia
HR	Human Resource
IFAC	International Federation of Accountants
IPSAS	International Public Sector Accounting Standard
JE	Journal entry
MDAs	Ministries Departments and Agencies
PIU	Project Implementation Unit
PSC	Public Sector Committee
RCRF	Recurrent Cost and Reform Financing
SFMIS	Somalia Financial Management Information System

30 June 2015

The Project Coordinator,
Recurrent Cost Reform Facility Project – Phase II
Ministry of Finance
Villa Somalia
Mogadishu

Dear Sir,

MATTERS ARISING DURING THE AUDIT FOR THE PERIOD ENDED 31 DECEMBER 2015

The Project Implementation Unit (PIU) within the Ministry of Finance is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by PIU are required to assess the expected benefits and related costs of internal control structure, policies and procedures. The objectives of an internal control structure are to provide PIU with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorised use or disposition, and that transactions are executed in accordance with PIU's authorization and recorded properly to permit the preparation of financial statements in accordance with Cash Basis IPSAS Financial Reporting under The Cash Basis of Accounting issued by Public Sector Committee of the International Federation of Accountants (IFAC-PSC) and Generally Accepted Accounting Principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected.

The report set out below is based on information availed to us and observations made during our audit of the Recurrent Cost Reform Facility Project – Phase II. Our review of the project's systems of internal control is carried out to assist us in expressing an opinion on the current period's financial statements of the project taken as a whole. This work is not primarily directed towards the discovery of weaknesses, the detection of fraud or other irregularities (other than those which would influence us in forming an opinion) and should not, therefore be relied upon to show that no other weaknesses or areas that require attention exist. The matters raised in this letter are those that have come to our attention during the audit and that we believe need to be brought to your attention. They are not a comprehensive record of all matters arising, and as such we cannot be held responsible for reporting all risks in your project or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as this report has not been prepared for, and is not intended for any other purpose.

We are therefore, pleased to provide this report and its recommendations on internal controls, accounting procedures and other matters, which came to our attention during our audit.

We take this opportunity to express our thanks to you and your staff for the co-operation, which we received during the course of our audit. We shall be grateful if you will let us have your comments on observations and recommendations raised in this management letter together with details of any consequential changes that are to be implemented or introduced.

Yours faithfully,



Dr Nur Farah

Auditor General, Federal Government of Somalia (FGS)

Date 30/06/2016

Villa Somalia

Mogadishu

1.0 INTRODUCTION

We have completed the audit of Recurrent Cost Reform Facility Project – Phase II for the period ended 31 December 2015. We have set out issues identified during the course of our normal audit work and have not attempted to indicate all possible improvements which a special review might develop.

1.1 Ranking

We have assigned priority ratings to the audit findings as follows:

Priority 1 - Urgent remedial action is required.

Key internal controls are absent or are not complied with on a regular basis. There is a fundamental weakness or deficiency in an internal control or in a series of internal controls which involves a substantial risk of either material error, or irregularity or fraud with regard to the expenditure and revenue stated in the Financial Report of the Project. There is a substantial risk of failure to achieve the control objectives for the Project which concern reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations notably the Contractual Conditions for the Project. Such risks could lead to an adverse impact on the financial report of the Project. Remedial action should be taken urgently.

Priority 2 - Prompt specific action is required.

There is a weakness or deficiency in an internal control or in a series of internal controls which, although not fundamental, relates to shortcomings which expose specific internal control areas (e.g. cash and bank management or budgetary and expenditure control) to a less immediate level of risk of either error, or irregularity or fraud. Such a risk could impact on the effectiveness of the internal controls and on the internal control objectives and should be of concern to the Entity's management. Prompt specific action should be taken.

Priority 3 - Specific remedial action is desirable.

There is a weakness or deficiency in internal control which individually has no major impact but where the Project would benefit from improved internal controls and/or where the Entity would have the opportunity to achieve greater effectiveness and/or efficiency. There is a possibility of undesirable effects at the process level, which, combined with other weaknesses, could give cause for concern.

2.0 SUMMARY OF MANAGEMENT LETTER POINTS

Ref	Summary of findings	Priority
2.01	Lack of standardized acquittal forms	2
2.02	Weaknesses in payroll System	2
2.03	Weaknesses in petty cash management	2
2.04	Weaknesses in human resource management	2
2.05	Failure to stamp support documents as "PAID"	3

2.01 LACK OF STANDARDISED ACQUITTAL FORMS

Description

The Project Management Unit should maintain financial files and records that are accurate, complete and up-to-date.

Key requirements in ensuring an accurate and complete set of financial files are effective financial control policies and procedures. However, we found that the financial control procedures concerning the acquittal of cash advances and administration of civil servants payroll was poor.

Further, article 7 of the EAFS procedure manual requires an "expense report form" to be completed at the earlier of project completion or 15 days of return from travel, showing a reconciliation of the expenditure against the advance. In-case of unsupported expenses, they should be recovered from the employee 30 days of return from travel.

- We noted that there was no formal evidence on the acquittal form used by staff that all the returns made by staff were either checked or approved. Indeed, in some of the payments we sampled there was no summary acquittal form, simply the documents. It would therefore appear that no checks were made to ensure that all the supporting documents were attached, that these documents agreed to the cash spent, that they were for the activity approved, or that the correct amount was returned and receipted. If there were any such checks, there was no formal evidence of them.

The instances noted are detailed in the table below;

Date/period	Ref.	Description	Payee	Amount advanced in US\$	Remarks
30.09.2015	JE 26/11	Advance payment Training into the (PA) Puntland State	Puntland State Of Somalia	49,133	From the request budget \$50,000 was requested and a Letter of No objection obtained from WB. An expense of \$ 49,133 Travel form and reconciliation sheets provided. However, imprest accountability forms (expense report form) have not been used, thus no evidence of someone independently checking the accountabilities.

Implication

- i. There is inadequate control over acquittals

Recommendation Priority

Priority 2 - Prompt specific action is required

Recommendation

- In order to ensure adequate control and accurate reporting of funds disbursed, the Project Implementation Unit should ensure that the financial control policies concerning the acquittals of cash advances are improved.

We recommend that the standard acquittal document be designed to allow staff to list the expenditure incurred, show the amount originally given and the difference either due back or owed to the claimant. The form should then have a place at the bottom for the checker and approver to sign and date, together with a box providing evidence of who received the cash back, and the receipt number used to receipt the cash returned.

The documents attached should be filed behind the form in the same order as they appear on the form and should ideally be numbered both on the form and on the documentation for ease of

checking. If many small receipts and invoices are involved, then a separate schedule should be attached summarising these documents and then only the total recorded on the acquittal document.

When signing as checker, this formally recognises that the following has been checked: that the document totals have been agreed to the acquittal form, that the documents are relevant to the approved activity that the acquittal form totals are correct and that cash due back or owed was correct.

The approver signs to confirm that they have checked that the checker has done his or her work, that the expenditure was in line with the approved activity, agrees with any report produced and was reasonable, that all the documents that should be attached are attached, such as the attendance sheets, and that the numbers of attendees, for example, was in line with what was originally approved. The approver would also ensure a receipt was issued for the cash returned and that the bank deposit slip is attached to confirm that the returned cash was deposited in the correct bank account. The checker should be the Finance Officer. The approver, in our opinion, should be the Project Coordinator (PC) as this person is more cognisant of what the expenditure was for and how it was spent. The PC will often have attended the function and will have approved the original budget for the activity. However, if this is not possible or practical, then the Accountant General should approve.

We further recommend that the travel advance should be liquidated within seventy two hours after return from the activity

Project Implementation Unit comment

Your recommendations raised are noted and management will endeavour to improve on the existing controls as recommended in respect of the following:

- 1) There is an adequate control over retiring advances and all forms related to it including report are maintained properly in accordance with the EAFS Manual.
 - Puntland requested funds to cover expense of training, and sent an estimated budget of \$49,133 to the World Bank, which received a No cost objection approval. At the time there were no funds in the project account, so the government of Puntland covered the training initially using its own funds, which it replenished once the first project fund transfers into the account were received from the FGS, with the balance acquitted back into the project account on time as evidenced on deposit slip provided. Acquittal of advance was done on time frame as shown on page 36 of EAFS Manual. However, if participants are from different state regions and traveled to different destinations, collecting all accountabilities may take longer
 - A deposit slip shows return of funds into the account. This deposit of acquitted was signed, reconciled and verified by Project Coordinator, certifying the return of balance amount into the project account.
 - The Bank statement further highlights the return of the remaining funds into the project account.
 - A Travel expense form detailing each expense incurred was received by the Project Coordinator. This form has the signature of each training participant and the approval signature of the Project coordinator. We will endeavour to complete the required cash advance forms as prescribed by the EAFS Manual. And we underline that we have been using reconciliation form any time there is a travel acquittals or retirement.

Further comments from the auditor

We reviewed the support documents provided and note that the PIU needs to standardize the acquittal forms and have the reviews evidenced on the acquittal form.

2.02 WEAKNESSES IN PAYROLL SYSTEM

Key requirements in ensuring an accurate and complete set of financial files are effective financial control policies and procedures. We found the following inadequacies with regards to the payroll:

We noted that there was no evidence of independent review of all the payroll listing prepared by the various Ministries, Departments and Agencies

Implication

There was inadequate evidence of internal checking as part of internal control system over the payroll. Lack of review and approval of the payroll listings poses a risk of failure to detect and rectify anomalies on a timely basis before making payments to the employees. The payroll listings prepared in Ms Excel also increases the administrative burden of preparing the payroll and increases risk of errors.

Recommendation Priority

Priority 2 - Prompt specific action is required

Recommendation

In order to ensure adequate control over the payroll listing and associated reports, we recommend that the project implementation unit should ensure that all the payroll listing bear the names and the designation of the person preparing, reviewing and approving the payroll from all the MDAs before processing and making payments to the employees.

We also recommend that the PIU should explore possibility of use of an IT based payroll system and put in mechanisms to have the payroll system integrated into SFMIS system.

Comments from Project Implementation Unit

Payroll lists in standardized payroll module form SFMIS are prepared by line ministries, departments and agencies with involvement and approval of National Civil Service Commission and are subject to independent review and reconciliation in accordance with detailed procedures by Accountant General. When reviews and reconciliations have been finalized, Accountant general produces summarized reconciled list with all MDAs. This has been sent to you for your reference with supporting authenticated schedules of civil servants payroll list to Central Bank of Somalia for payment.

There is strong and adequate internal control over payroll listing. Standardized Golden List of civil servant employees authenticated by both National Civil Service Commission and Accountant General was uploaded into payroll module in Somali Financial Management Information System and updates are administered accordingly. Spending authority and paying authority are independently making reviews and controls on payroll lists. Payroll system is fully integrated into SFMIS and there is no payroll list prepared in Ms Excel.

2.03 WEAKNESES IN PETTY CASH MANAGEMENT

Description

The Project Management Unit should maintain financial files and records that are accurate, complete and up-to-date.

Key requirements in ensuring an accurate and complete set of financial files are effective financial control policies and procedures. An important financial control is effective segregation of duties to ensure that individuals responsible for authorizing or approving expenditure are not also directly involved in payments.

However, we noted that the Project Coordinator was responsible for approving petty cash expenditure as well as facilitating petty cash payments. The Coordinator is also the petty cash holder for the PFM 1 petty cash float.

The project has a petty cash float with a maximum limit of US\$3,000. The custodian of the petty cash float is the project coordinator. We however noted that the petty cash float is not kept in a safe and it is not insured. Further we noted that the petty cash float was advanced in February 2015 and as at the time of the audit US\$1,421 was still cash at hand and the petty cash reconciliation was done once on 30 March 2016.

Implication

There is inadequate segregation of duties over petty cash management
Lack of safe custody of cash poses risk of loss of funds.

Recommendation Priority

Priority 2 - Prompt specific action is required

Recommendation

In order to ensure adequate control is exercised over petty cash expenditures, the Project Management Unit should segregate duties in the area of facilitating petty cash payment and approval of petty cash expenditure.

We recommend that the project management unit should ensure safe custody of the petty cash float. This can be done by ensuring cash safe is procured. Petty cash reconciliations should also be done on a regular basis. Considering the amount of time it has taken to exhaust the petty cash amount of USD 3,000, we recommend that the amount be reduced to be in line with current project cash requirements.

Project Implementation Unit comment

Segregation of Petty Cash approval and payment - It can be explained that this has been the practice in the past and had not previously been raised as a control issue. It can also be further explained that it is done mainly to centralize controls at the highest level taking into account the risks associated with cash. However your recommendation in this regard will be reviewed by management with a view to strengthening the segregation controls.

Safekeeping – Your recommendation in respect of procurement of a safe for the safe keeping of the petty cash is noted and management will review this vis-à-vis the physical and access security issues.

Frequency of Petty Cash Reconciliation – We noted your recommendation for regular reconciliation of petty cash. We will review this frequency based on the risks involved and also the time that it may involve so that the benefits of regular reconciliation is aligned with the costs in terms of time and the perceived risks. Carrying out regular reconciliations which is not aligned with the perceived risks and costs in terms of time needed to carry out such regular reconciliation could be counter-productive.

2.04 WEAKNESSES IN HUMAN RESOURCE MANAGEMENT

Key requirements in ensuring an accurate and complete set of financial files are effective financial control policies and procedures.

We noted that, the permanent Secretary Ministry Of finance Jubbaland Mr Mohamuud Yasin Jama staff IS 013 who is paid from the project has no personnel file maintained.

Implication

The entity may not be able to monitor staff details effectively in the absence of staff file.

Recommendation Priority:

Priority 2 - Prompt specific action is required

Recommendations

We recommend that the project implementation unit should ensure that the personnel files are availed for audit verification and minimum details that should be contained in the personnel files includes a copy of curriculum vitae, academic certificates, identification number/passport number, letter of offer of employment, employment contract, annual performance appraisals, letter of promotion amongst other relevant information that pertains to the Civil Servant.

Project Implementation Unit comment

The external Assistance Fiduciary Section (EAFS) acknowledges that personnel files are an integral component of accountable human resource management. With the introduction of the Civil Service Commission, responsible for setting the procedures in relation to these matters, the record keeping is now satisfactorily accomplished in consultation with the Ministry of Finance HR Department. EAFS will continue to ensure that satisfactory personnel records, as identified in the recommendation, are available for audit purposes.

2.05 FAILURE TO STAMP SUPPORT DOCUMENTS "PAID"

Description

We noted instances where the entity had not cancelled all the expense documents on which payment had been settled as "PAID" to distinguish them from either unpaid expenses or reduce the likelihood of multiple payments being made based on the same set of documentation.

Implication

Failure to indicate documentation as "PAID" increases the likelihood of multiple payments based on the same set of documentation.

Recommendation Priority:

Priority 3 - Specific remedial action is desirable.

Recommendations

We recommend that the management ensures that all documents on which payment have been made should be stamped "PAID" to distinguish them from unpaid expenses.

Project Implementation Unit comment

This recommendation came in last year's audit and by that the time 2015 was already half way and therefore apparent that some of the payments relating to period before the implementation of audit recommendation may be not have been duly stamped as "Paid. Since the implementation of the recommendation, all processed payments are duly stamped "PAID". The risk of payment documents being recycled as highlight in your recommendation as a potential risk is not likely because of the other complementary controls – original payment documents are maintained at the Accountant General's Department and not at the EAFS which handles project payments.

It must also be recognized that payment process is done under through strict control procedures. For each invoice, there must be supporting payment documents which have to go through the various internal control procedures in relation to the processing of payments.

Apart from stamping the processed payments as "PAID", invoices are given payment voucher number at the top right corner that evidenced the invoice is being paid. All two type of vouchers and warrant contain full particulars of each invoice attached with, such as dates, amount, numbers, quantities, payee name and rates, so as to enable them to be checked without any other documents as payment voucher number is visibly shown and quoted at top corner of each forms.

Upon completion of all control and verifications, payment shall only be made to the person to whom it is due, unless written authority has been given by payees for payment to be made to his/her representative. If the authority is for one payment only, it should be attached to the relevant voucher. Where more than one payment is covered by the authority, a number should be quoted on the authority, which should be prepared in duplicate, where duplicate copy being attached to the voucher and all documents including invoice would be uploaded into SFMIS as attachment.

Once invoice is given Payment Voucher Number at the top right corner in readable ink, it shows amount on invoice has been paid and it will not be reusable so far. The above detailed payment steps are derived from Somali Republic Financial Regulations and are enough as to be a safe guard of the likelihood of multiple payments from same set of documentation.

In view of the controls surrounding the payment process, it is highly unlikely for an invoice to be recycled and thus your recommendation to use "Paid Stamp" is an additional safeguard measure but there are already existing complementary measures embedded in the payment authorization and approval processes itself.

3.0 PREVIOUS YEAR MANAGEMENT LETTER FOLLOW UP

	Previous Audit finding	Current status	Management comments
1	Inadequacies in Payroll listing	similar finding noted during the audit, section 2.02 above	Addressed above
2	Weaknesses in human resources Management	similar finding noted during the audit, section 2.03 above	Explained above
3	Insufficient supporting documents	No similar finding noted during the audit.	N/A
4	Inadequate assets management	No similar finding noted during the audit.	N/A
5	Poor Record keeping	No similar finding noted during the audit.	N/A
6	Lack of timesheets	No similar finding noted during the audit.	N/A