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Resilient nations.*

**AUDIT**

**OF**

**UNDP COUNTRY OFFICE**

**IN**

**GUATEMALA**

**Report No. 1723**  
**Issue Date: 18 November 2016**

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## Report on the Audit of Guatemala Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of UNDP Guatemala (the Office) from 29 August to 9 September 2016. The audit aimed to assess the adequacy and effectiveness of the governance, risk management and control processes relating to the following areas and sub-areas:

- (a) governance and strategic management (organizational structure and delegations of authority, leadership/ethics and values, risk management, planning, business continuity, monitoring and reporting, financial sustainability);
- (b) United Nations system coordination (development activities, Resident Coordinator Office, role of UNDP – “One UN”, Harmonized Approach to Cash Transfers);
- (c) programme activities (programme management, partnerships and resource mobilization, project management); and
- (d) operations (human resources, finance, procurement, information and communication technology, general administration, safety and security).

The audit covered the activities of the Office from 1 January 2015 to 31 July 2016. The Office recorded programme and management expenditures of approximately \$65 million as of 31 July 2016. The last audit of the Office was conducted by OAI in 2013.

The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

### Overall audit rating

OAI assessed the Office as **partially satisfactory**, which means, “Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.” This rating was mainly due to deficiencies in the management of service contracts, weaknesses in the E-banking payment process, payments processed outside of the Atlas system (enterprise resource planning system of UNDP), deficiencies in the management of vendor accounts.

**Key recommendations:** Total = 11, high priority = 4

The 11 recommendations aim to ensure the following:

Objectives	Recommendation No.	Priority Rating
Achievement of the organization’s strategic objectives	2, 3, 4, 6	Medium
Reliability and integrity of financial and operational information	8, 9, 10	High
Effectiveness and efficiency of operations	1	Medium
Safeguarding of assets	11	Medium
Compliance with legislative mandates, regulations and rules, policies and procedures	5	Medium
	7	High

For high (critical) priority recommendations, prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP. All high (critical) priority recommendations are presented below:

**Deficiencies in the management of the service contracts (Issue 7)** In paying the remuneration of service contract holders, salaries were processed through the monthly payroll in Atlas and payslips were issued to each contractor. Concurrently, the Office requested the contractors to issue invoices for services rendered on a monthly basis, thus in effect simultaneously treating service contractors as Office employees and as individual company owners. When the Office actually paid for invoices, they also issued a Value Added Tax (VAT) exception certificate commensurate to the tax on each invoice, which could have enabled the contractors to avoid payment of VAT to the national tax authority.

Other deficiencies identified in the hiring of service contract holders were the use of different contract templates than the standard UNDP template, lack of verification of qualifications and credentials of hired individuals, and lack of proof of enrollment in a pension fund at the beginning of the contracts.

**Recommendation:** The Office should improve the management of service contracts by: (a) immediately discontinuing the issuance of certificates as a basis for exemption for VAT payments; (b) verifying candidates' qualifications and credentials prior to the selection and hiring of a service contract holder; and (d) seeking advice from the Office of Human Resources and the Office of Financial Resources Management on how to handle the pension and other social security benefits for service contract holders in the Country.

**Weaknesses in E-banking payment process (Issue 8)** The controls in the execution of the E-banking payment process were weak and cumbersome due to the following:

- The Finance Assistant who processed payments in Atlas selected and included all approved vouchers in the daily paycycle without verifying the supporting documentation of those vouchers. Then all information from the paycycle was being downloaded from Atlas in a "text format file" (not password protected or encrypted) and stored in the share-drive. This text file was converted using a locally developed application to make it compatible with the E-banking web application. The converted file was then manually modified to change the date format from English to Spanish and eventually uploaded in the E-banking web application. This process was not only cumbersome, but exposed the process to manipulation of data.
- A print out of the locally developed application for payments, rather than from Atlas, was compared against the information uploaded in the E-banking application. Consequently, the original information downloaded from Atlas was not verified against the information in the actual electronic fund transfers (EFT) payments.

The following gaps regarding access to the E-banking web application were also noted:

- The Finance Analyst was the only one who had the approver right to release payments online, which was not aligned with the Internal Control Framework

that established two approvers.

- The Operations Manager, who had the administrator role of the E-banking web application, was able to modify user profiles online without any other approval required.
- Two bank signatories did not have access to the E-banking web application.

It was also noted that the E-banking application used by the Office was not approved by the UNDP Treasury Unit.

**Recommendation:** The Office should strengthen the internal controls over payments and minimize business risks by: (a) selecting and processing payments in Atlas for which adequate and valid documentation supporting payments exists; (b) developing an automated application to interface Atlas to the E-banking web application and eliminating the manual conversion of information in these systems; and (c) establishing two individuals with approving rights to jointly approve online payments and providing online access to the application for all authorized bank signatories.

Payments to individual consultants processed outside Atlas system (Issue 9)

The Office processed payments to consultants hired by NIM projects. The contracts and related payments were managed and made through a locally developed application system. At the end of each month, the total amount paid to all consultants for that month was entered as a single transaction in Atlas under a generic name of a vendor. As a result, tracing the payments to individual consultants in Atlas was not possible. During the audit period, there were 12 projects using this modality involving 282 contractors and the amount paid was estimated at \$1.6 million. When the information in the locally developed application was compared with Atlas, it was observed that 62 contractors had also received payments (\$480,000) for other services not linked to the contracts managed through the locally developed application.

**Recommendation:** The Office should process all payments through Atlas and identify the specific vendor and the project for each and every payment transaction.

Deficiencies in management of vendor accounts (Issue 10)

Non-compliance with Internal Control Framework requirements when creating a new vendor in Atlas or in the E-banking application led to inconsistent data in these systems. The audit identified 5,538 vendors created in the E-banking application, while there were 3,683 vendors registered in Atlas. Additionally, documentation to assess the accuracy of the banking information was not requested, contrary to the requirements of the 'UNDP Programme and Operations Policies and Procedures'.

The Office used generic vendors such as "Local staff" or "UNDP proyectos especiales" in processing payments and granting advances to project personnel and entering the expenses in Atlas. These amounted to approximately \$23.6 million, or 38 percent of total payments made by the Office during the period audited.

**Recommendation:** The Office should strengthen vendor management by: (a) requiring submission of supporting documentation for vendor profile creation and performing data review of vendors' information in Atlas to ensure that information is accurate and complete; (b) reviewing the process of creating vendors in the E-banking web application by restricting access to do so and by having independent approval of new vendors created; and (c) aligning Atlas vendors' information to the information in the E-banking system.

**Implementation status of previous OAI audit recommendations:** Report No. 1182, 24 January 2014.

Total recommendations: 15

Implemented: 13

Withdrawn: 2

**Management comments and action plan**

The Country Director accepted all 11 recommendations and is in the process of implementing them. Comments and/or additional information provided had been incorporated in the report, where appropriate.

Issues with less significance (not included in this report) have been discussed directly with management and actions have been initiated to address them.



Helge S. Ostveiten  
Director  
Office of Audit and Investigations

## I. About the Office

The Office, located in Guatemala City, Guatemala (the Country) had 32 staff members and 77 service contract holders at the time of the audit. The project portfolio consisted of directly implemented (DIM) projects (62 projects) and NIM projects (17 projects). The projects focused on judicial reform, security and rule of law, strengthening local governance processes, and environment. At the time of the audit, the Resident Representative position was vacant and the Office was headed by the Country Director, who was functioning as the Resident Representative ad interim.

## II. Audit results

Satisfactory performance was noted in the following areas:

- (a) Leadership, ethics and values. Overall, staff members were aware of the Office's priorities, challenges and control objectives regarding ethical behavior. No reportable issues were identified.
- (b) Development activities. Implementing partners, United Nations agencies, and donors with whom OAI met during the audit mission expressed their appreciation of the Office as a valued development partner.
- (c) Resident Coordinator Office. The United Nations Country Team shared the common goal of improving coordination within the United Nations system and were helping on the strengthening of the governance and improving the justice system in the Country.
- (d) General administration. Controls over general administration activities, including common services, fuel management, vehicle management and travel management, were found to be adequate. Physical verifications of the Office's assets were periodically conducted.
- (e) Safety and security. UNDSS shared the Office premises and as such issued basic emergency instructions for new and emerging contingencies on a continuous basis.

OAI made four recommendations ranked high (critical) and seven recommendations ranked medium (important) priority.

Low priority issues/recommendations were discussed directly and agreed with the Office and are not included in this report.

### High priority recommendations, arranged according to significance:

- (a) Improve the management of service contracts (Recommendation 7).
- (b) Strengthen the internal controls over payments and minimize business risks (Recommendation 8).
- (c) Process all payments through Atlas and identify the specific vendor and the project for each and every payment transaction (Recommendation 9).
- (d) Strengthen vendor management (Recommendation 10).

### Medium priority recommendations, arranged according to significance:

- (a) Strengthen support to nationally implemented projects (Recommendation 5).
- (b) Strengthen the management of cash advances (Recommendation 11).
- (c) Undertake a review and update organizational structure and functions of all units (Recommendation 1).
- (d) Improve financial sustainability (Recommendation 3).

- (e) Strengthen monitoring, risk management and reporting activities (Recommendation 2).
- (f) Fully adopt the Harmonized Approach to Cash Transfers (Recommendation 4).
- (g) Adhere to the prescribed procedures for project appraisal (Recommendation 6).

The detailed assessment is presented below, per audit area:

## A. Governance and strategic management

### 1. Organizational structure and delegation of authority

#### Issue 1 Weaknesses in organizational structure and unclear roles and responsibilities

The 'UNDP Operational Guide of the Internal Control Framework' stipulates that each head of office has the overall responsibility for establishing and maintaining adequate internal controls, and for ensuring documentation of their office's internal control procedures. Further, the 'UNDP Programme and Operations Policies and Procedures' define the control environment as one of the components of the internal control system that provides the foundation for an effective internal control. The vision and mission of an office as well as its organizational effectiveness rely on the office's adequate organizational structure, which allows for clear roles and responsibilities, as well as reporting lines.

The audit identified weaknesses in the organizational structure and unclear roles and responsibilities among the various departments and units within the Office, as follows:

#### Conflicting roles and responsibilities in Finance Unit

- A Finance/Treasury Associate staff was performing incompatible tasks, being in charge of recording contribution agreements, booking deposits, uploading the payment list in the E-banking system, and preparing bank reconciliations, and also acted as the petty cash custodian.
- The bank reconciliation function had been performed by one finance staff after the retirement of the staff dedicated to bank reconciliation; however, there was no established plan to officially cover this function.
- Medical advances granted to one staff member (one in 2015 and another one in 2016) were cleared through a journal voucher entered in Atlas by the same staff member.
- 19 purchase orders and requisitions totalling \$4,011,279 were raised and approved by the same individual.
- Only one vendor approver was appointed in the Atlas system, which was not in line with the Internal Control Framework.

#### Inadequacies in Programme Unit structure/functioning

- The programme coordination function of the Office weakened following the abolition of the Deputy Country Director post in 2015 and the Assistant Resident Representative – Programme post in 2013. These resulted in inadequate coordination, insufficient integration, and a lack of communication and control over programme activities among the various programme areas.
- For some DIM projects, the project units were composed of several staff members in charge of the programme and operation support functions needed for each project. However, office staff was



assigned to DIM projects while not reflecting true needs, as Administration Associate and driver posts were added as part of each project team. Therefore, the Office's capacity to support DIM projects was overstated, which unnecessarily increased project costs and hindered cost recovery for the Office.

- The Country Director, or in his absence, the Operations Manager, signed all Funding Authorization and Certificate of Expenditure (FACE) forms to approve payments for DIM projects irrespective of the monetary value. The appropriate process would have been to have DIM project expenses approved in the system by appropriate staff other than the Country Director or the Operations Manager, to enable the more efficient processing of payments following proper delegation.

An organizational structure without clear reporting lines and one that is not aligned with the respective functions of the Office may result in unclear roles, responsibilities, and accountabilities. Furthermore, inadequate segregation of duties and blurred reporting lines may jeopardize the effectiveness of the entire internal control system, which can lead to inefficiencies as well as the untimely detection of errors and to financial losses for the organization.

Priority	Medium (Important)
<b>Recommendation 1:</b>	
The Office should undertake a review and update its organizational structure and the functions of all units in order to:	
<ul style="list-style-type: none"> <li>(a) clarify roles, responsibilities and accountabilities; and</li> <li>(b) ensure that adequate segregation of duties is maintained.</li> </ul>	
<b>Management action plan:</b>	
The Office will undertake the following:	
<ul style="list-style-type: none"> <li>▪ The previous backup for bank reconciliation retired a few months ago. The Office is in the process of identifying a new back up for this activity.</li> <li>▪ The vouchers approved by the same staff member correspond to the journal vouchers that record the credit of the deposit made in order to clear the advances. The Office will take into account the recommendation of OAI to not approve journal vouchers (Recovery of Medical Advances) by the same staff member.</li> <li>▪ According to the UNDP Strategic Plan and the Country Programme, the Programme Unit will be re-organized by cluster: Inclusive Sustainable Development and Democratic Governance, Rule of Law and Peace. The coordination inter-cluster will be promoted. Also, the Management Support Unit will be strengthened regarding the programme monitoring and follow up.</li> <li>▪ Assess the overlapping between the DIM project teams and the Office's capacity to support DIM projects, regarding the unnecessary costs and avoid double operational expenses.</li> <li>▪ Review the current documentation workflows.</li> <li>▪ Review the recommendation by OAI to establish thresholds for which the Country Director is required to sign/approve FACE forms.</li> </ul>	
<b>Estimated completion date:</b> June 2017	

## 2. Risk management, planning, monitoring and reporting

### Issue 2 Weaknesses in monitoring, risk management and reporting activities of projects

Monitoring is driven by the need to account for the achievement of intended results and to provide a factual basis for timely decision-making. It is an essential management tool to support UNDP's commitment to accountability for results, resources entrusted to it, and organizational learning. Monitoring relates to pre-identified results in the development plan that are achieved throughout project implementation, where baselines, indicators, targets and measurements of results are clearly defined and regularly monitored. Monitoring frameworks at the project level also ensure that projects are implemented within the agreed timeframe and when completed are timely closed to capture the lessons learned.

The audit reviewed a sample of six ongoing projects that comprised 27 outputs (representing 67 percent of total programme delivery for the review period) out of a total of 46 projects comprising 79 outputs. The audit found that all project documents reviewed contained a monitoring framework detailing monitoring activities to be carried out during the life cycle of each project; such activities entailed preparing quarterly project progress reports, including the financial monitoring of project annual work plans and field visits. In four out of six cases, those monitoring activities were carried out annually and not quarterly as stipulated in the project documents due to the fact that project board meetings were held annually, as confirmed by the Office.

In addition, the Office carried out risk assessments when formulating the projects as required; however, the risk assessments and results thereof were not quarterly updated and recorded in Atlas as required by the monitoring frameworks.

Furthermore, some partners and counterparts interviewed by OAI, ranging from donors to implementing partners, expressed concerns on the level of detail and consistency of project reports. For instance, they referred to the fact that in the beginning of the year, an Annual Work Plan for each project was approved by project boards and by the end of the year, they received a Combined Delivery Report, which only showed expenses incurred by the project. Therefore, it was not possible to compare them with the Annual Work Plan and budget in order to properly assess the use of resources.

Projects were exposed to risks for which mitigating actions were not planned/carried out. The lack of effective monitoring may impede the Office from determining whether intended results are being achieved and reported to main stakeholders, and whether corrective actions are necessary to ensure the delivery of intended results.

<b>Priority</b>	Medium (Important)
<b>Recommendation 2:</b>	
The Office should strengthen monitoring, risk management and reporting activities by:	
<ul style="list-style-type: none"> <li>(a) timely carrying out the activities described in the project monitoring frameworks;</li> <li>(b) performing project risk assessments as stipulated in the project documents and recording them in Atlas; and</li> <li>(c) improving the level of project reporting to main stakeholders.</li> </ul>	
<b>Management action plan:</b>	
(a) and (c) About the reforms for improving the quality of UNDP programmatic work, the Office will make	

substantive revisions to include the new monitoring plan required by the new project document template. This plan will be adapted to the project context, as needed, including the project reporting to main donors and stakeholders. In addition, monitoring activities will be strictly enforced under the responsibility of programme officers.

- (b) The Office will promote common understanding regarding the risk categories and the difference between issues and risks. The risks identified should be managed, mitigated with activities and resources of the projects themselves.

**Estimated completion date:** June 2017

### 3. Financial sustainability

#### Issue 3 Office's financial sustainability at risk

Recovering project costs, including the application of Direct Project Costing (DPC) to programme/project activities enhances financial sustainability. To that effect, direct project costs that directly contribute to the achievement of development results of projects and programmes become a key component of any business unit's budget. In addition, the 'UNDP Programme and Operations Policies and Procedures' require offices to establish effective partnerships, develop a Resource Mobilization Strategy, as well as implement a corresponding Resource Mobilization Action Plan.

The Office faced challenges similar to those confronted by any middle or high-income country, which included: (a) increased operational costs; (b) reduced inflow of core resources; and (c) untimely collection of Government Contributions to Local Office Costs (GLOC). The financial situation was further aggravated by the fact that delivery targets were lower therefore decreasing the resources from the projects required to meet the Office's break-even point level in 2015 and 2016. Furthermore, national legislation limited the Office's capacity to provide project services that in the past allowed for cost recovery, and supported the enhancement of its reserve, and its cost structure.

There was a reduction in the extrabudgetary reserves, as programme delivery decreased from \$40.9 million in 2014 to \$36.6 million in 2015. If the same trend of declining extrabudgetary reserves were to continue in 2016, then the financial situation of the Office could be compromised considering that the current Office cost structure break-even point was \$50 million of programme delivery while the target set was \$40 million. In addition, the Office was not recovering costs for activities being undertaken for NIM projects. Regarding the GLOC, despite the Office having recently collected \$0.5 million of pending GLOC (after an OAI audit field visit) corresponding to the period 2008-2014, \$0.5 million remained uncollected.

The Office recently started a portfolio analysis (including the pipeline composition) aimed at determining the required Office set-up and required cost structure for a financially viable Office. The Office was also finalizing its Resource Mobilization Strategy for the approval of the Regional Bureau for Latin America and the Caribbean (RBLAC).

The lack of financial resources and of financial planning that are based on expected programme deliveries may put at risk financial sustainability and could negatively impact the achievement of UNDP's overall mandate in the Country.

<b>Priority</b>	Medium (Important)
<b>Recommendation 3:</b>  The Office should improve its financial sustainability by: <ul style="list-style-type: none"> <li>(a) reassessing, together with the Regional Bureau, the way delivery targets and cost recovery charges are set vis-à-vis Office costs to ensure sustainability;</li> <li>(b) reviewing the cost recovery charges for project activities and using DPC;</li> <li>(c) reducing operational costs to a point where they are sustainable;</li> <li>(d) establishing a strategy to fully recover the outstanding GLOC; and</li> <li>(e) revisiting the project pipeline and improving resource mobilization, and to the extent possible starting new development projects.</li> </ul>	
<b>Management action plan:</b>  <ul style="list-style-type: none"> <li>(a) and (d) and (e) The Office will continue the efforts to increase delivery and reinforce the pipeline as well as to try to recover the pending GLOC.</li> <li>(b) The Office will request RBLAC for support in implementing Direct Project Costing and for consultation on the best practices within the region.</li> <li>(c) The Operations Unit will prepare an action plan for reducing costs in line with the Office profile, programmes, projects, and pipeline.</li> </ul>	
<b>Estimated completion date:</b> June 2017	

## B. United Nations system coordination

### 1. Harmonized Approach to Cash Transfers

#### Issue 4 Harmonized Approach to Cash Transfers not fully implemented

To lessen the burden caused by the multiplicity of United Nations procedures and rules for its partners, the 'Framework for Harmonized Approach to Cash Transfers to Implementing Partners' requires that participating United Nations agencies (UNDP, UNICEF and UNFPA) agree on and coordinate the Harmonized Approach to Cash Transfer (HACT) activities. Compliance is achieved when the following four steps have been completed: (a) macro-assessment of the public financial system; (b) micro-assessments of implementing partners; (c) agreement with the Government on implementing the HACT; and (d) development and implementation of an assurance and audit plan for implementing partners.

At the time of the audit mission, HACT was not fully adopted despite the efforts placed in 2015 for its full adoption. A macro-assessment had been carried out along with micro-assessments of implementing partners. The use of FACE forms had been enforced although not fully applied in all cases (e.g. request for direct payments) while spot checks remained as a pending matter. It was expected that the Office would be fully transitioned for HACT compliance in the second half of 2016.

Unless all of the HACT requirements are implemented, the objectives of harmonizing practices among United Nations agencies are at risk of not being achieved.

<b>Priority</b>	Medium (Important)
<b>Recommendation 4:</b>	
The Office should fully adopt the Harmonized Approach to Cash Transfers by:	
<ul style="list-style-type: none"> <li>(a) enforcing the use of FACE forms; and</li> <li>(b) developing an assurance plan and conducting spot checks, as required.</li> </ul>	
<b>Management action plan:</b>	
<ul style="list-style-type: none"> <li>(a) The Office will coordinate with the Office of Financial Resources Management in regard to the authorization for changes made to the FACE form.</li> <li>(b) The 2016 pending spot checks will be completed before 31 December 2016. The documents (spot checks) will be uploaded to CARDS.</li> </ul>	
<b>Estimated completion date:</b> June 2017	

## C. Programme activities

### 1. Programme management

#### **Issue 5**      Lack of adherence to corporate guidelines for nationally implemented projects

In accordance with the 'National Implementation by the Government of UNDP Supported Projects: Guidelines and Procedures' (guidelines for NIM projects), such projects are to be implemented following one of two scenarios: (a) full national implementation, in which the national implementing partners directly assume responsibility for the related outputs and carry out all activities towards the achievement of those outputs; or (b) national implementation, in which the national implementing partner assumes full responsibility for the related outputs, but where at the request of the Government through a standard Letter of Agreement for support to national implementation, UNDP serves as a responsible party that undertakes specific, clearly defined activities for the implementing partner.

The Office was using an outdated national execution manual dated March 2008 that was agreed upon with the Government to guide project execution, but not aligned to the existing guidelines that went into effect in January 2012. OAI identified the following discrepancies in the use of the outdated manual:

- The Office was providing support to projects under national implementation without the required standard Letter of Agreement where the list of services and the associated costs are to be clearly specified. Instead, the Office was using generic management arrangements contained in the project documents. As a consequence, unclear roles between the Office and the implementing partners were noted and the audit exercise of the NIM projects was impacted. This was because all of the expenses were reported as if they were incurred by the implementing partners and project activities and expenses carried out by the Office were comingled with those of the implementing partners. These were then audited by external auditors, which impacted that audit process and contravened the single audit principle.

As part of the support to projects under national implementation, the Office carried out most of the procurement activities but not the signing of the awarded contract. This contravened the NIM procurement guidelines, which prescribe that every procurement activity must be undertaken by the same entity (Government or UNDP) from sourcing, to contract signing and contract management. During the period covered by the audit, the Office undertook procurement action for \$22.7 million. Out of this amount, approximately \$20 million corresponded to NIM projects. While the guidelines take into account that there is collaboration and consultation among all the parties during the entire procurement process, it also states that the entity managing the process and the contract shall be the same entity that takes full accountability and responsibility until the contract is completed. For instance, in one procurement case, the Office conducted sourcing of vendors and participated in the evaluation committee, and the implementing partner carried out the drafting of the terms of reference, evaluation, and signing of the contract. In this case, the Office conducted procurement services for a NIM project, which thus constituted Country Office support to NIM. For this type of situation, the Office should have had a Letter of Agreement with the partner.

- The audit also identified a general pattern of contracts being signed between the projects and contractors that did not follow any of the standard templates that should have been used by implementing partners for NIM projects (refer to Issue 9).
- The UNDP logo was used in project procurement solicitation documents and contracts, even though the contracts were signed by the national partner.

Not using the appropriate guidelines for NIM projects may result in unclear roles and responsibilities among the Office's staff and implementing partners, exposing UNDP to legal and reputational risks. The use of non-standard contracts by NIM projects that involve UNDP could expose the Office to legal consequences and/or reputational damage, while the incorrect use of the UNDP logo could have legal implications for the Office as well.

The previous audit conducted by OAI in 2013 had identified similar weaknesses; however, the implementation of the recommendation made at the time was heavily dependent on Government action and therefore withdrawn by OAI. Given that the above stated risks still remain, OAI made a new more expanded recommendation to this respect.

<b>Priority</b>	Medium (Important)
<b>Recommendation 5:</b>	
The Office should strengthen support to nationally implemented projects by:	
<ul style="list-style-type: none"> <li>(a) implementing the current guidelines for nationally implemented projects for all new and ongoing projects, as required; and</li> <li>(b) requesting projects to refrain from using non-standard contracts and discontinue the use of the UNDP logo in documentation that does not involve the Office.</li> </ul>	
<b>Management action plan:</b>	
<ul style="list-style-type: none"> <li>(a) The Office will reassess nationally implemented projects and implement guidelines.</li> <li>(b) The Office will ask projects to use standard template contracts and discontinue the use of the UNDP logo in project documentation.</li> </ul>	
<b>Estimated completion date:</b> June 2017	



## 2. Project management

### Issue 6 Local Project Appraisal Committee meetings minutes contained insufficient information

According to the 'UNDP Programme and Operations Policies and Procedures', as part of the project appraisal process, UNDP representatives and stakeholders shall ensure that projects are designed with clear and measurable results based on standard templates. All projects and substantive revisions should be reviewed by a Local Project Appraisal Committee (LPAC) to ensure that outputs are aligned with the planned results contained in the Country Programme Document and the UNDP's Strategic Plan. The LPAC should also ensure that a proper project management structure is in place to monitor and evaluate results, including the implementation modality, which in case of direct implementation, should include the authorization from the corresponding Regional Bureau. The membership of the LPAC should be comprised of UNDP staff members, a representative of the Government Coordinating Agency and a representative of the implementing partner. The minutes of the meetings shall comprise of the approved project quality assessment for design and appraisal and a summary of the LPAC's discussions and recommendations.

The audit reviewed a sample of six development projects and found that the minutes of the LPAC meetings had limited information on UNDP's quality standards, such as the feasibility of project implementation, timeframe, monitoring and evaluation framework, and an analysis of the capacity assessment of the implementing partners. In addition, the LPAC was comprised of Office staff only, as no signature of a Government Coordinating Agency representative was found in the meeting minutes. Furthermore, the Office approved DIM projects without the written authorization of RBLAC, thereby exceeding its delegated authority for project approval.

Weaknesses in the review of project design and quality standards might not only compromise the achievement of expected results, but may also expose the Office to reputational risks. In addition, not having a Government Coordinating Agency representative may make national ownership of approved projects unclear.

Priority	Medium (Important)
<b>Recommendation 6:</b>  The Office should adhere to the prescribed procedures for project appraisal by: <ul style="list-style-type: none"> <li>(a) ensuring that LPAC meeting minutes reflect the quality assessment of approved projects;</li> <li>(b) reviewing the composition of the LPAC to include a representative of the Government Coordinating Agency; and</li> <li>(c) refraining from approving directly implemented projects without the required authorization of RBLAC.</li> </ul>	
<b>Management action plan:</b>  The Office will improve the Local Project Appraisal Committee (LPAC) meetings, by requiring the following elements: <ul style="list-style-type: none"> <li>▪ Implementation of a checklist.</li> <li>▪ More substantive discussions for improving the quality design of projects.</li> <li>▪ The members of LPAC meeting will include the representative of the Government and implementing partners.</li> <li>▪ The LPAC minutes will comprise all discussions (e.g. operative and substantive).</li> <li>▪ The Office will not approve projects without RBLAC authorization for DIM projects.</li> </ul>	

**Estimated completion date:** June 2017

## D. Operations

### 1. Human resources

#### Issue 7 Deficiencies in management of service contracts

Country Offices are expected to comply with the 'Service Contract User Guide' in the management of service contracts. Based on this Guide, UNDP Country Offices must ensure that individuals engaged under service contracts are covered under an appropriate pension scheme. In the Country, the option chosen was the use of a pre-existing private pension scheme. By choosing this pension option, UNDP offices must receive adequate evidence that the individual has medical insurance and pension coverage. Under this arrangement, the reasonable and customary lump sum amount for social security benefits is added to the base remuneration of the contract holder. Service contracts should not include a lump sum for social security benefits when no coverage is in place.

The review of a sample of 10 out of a total of 119 service contracts managed by the Office identified the following:

#### Hiring process

- Contractors' qualifications and credentials were not requested or verified, creating a risk of hiring unqualified individuals.
- The standard contract template signed by UNDP and by the service contract holders was modified with the omission of the clauses on norms of conduct expected from contractors, remuneration package, and performance bonuses from the template; however, these were paid by the Office. Since these remunerations and bonuses were not set out in the signed contracts, these payments may not have had a legal and contractual basis.
- Proof of enrollment in a pension fund was requested at the beginning of the contracts. According to the Office, this was due to the fact that an individual is not allowed to enroll in a pension fund in the Country. Instead, a certificate for a fixed-term deposit of 60 months was presented by each individual contract holder. However, this fixed-term deposit was not equivalent to a pension fund and therefore not in line with the relevant provisions in the Guide.

#### Payment process

In paying service contract holders, their remunerations were processed like salaries of Office employees through the monthly payroll in Atlas, and a payslip was issued to each one of them. Concurrently, the Office requested them to issue invoices for services rendered on a monthly basis. This arrangement was in effect simultaneously treating service contractors as both Office employees and as individual company owners. When actually paying for the invoices, the Office also issued a VAT exception certificate commensurate to the VAT due on the invoice. This could have enabled the contractors to avoid the payment of VAT to the national tax authority. According to the Office, this practice had been in place for approximately 10 years. However, the Office has no authority to



grant any kind of tax exemption; it can only implement tax exemptions granted and duly authorized by the host government.

This practice led the Office to applying two different contractual modalities for the same individual under the rules and regulations of both UNDP and the Government.

Management also informed the audit team of a decision taken to discontinue the use of legal advisors hired locally and to channel any request for advice to the Legal Office at Headquarters. Indeed, there are legal issues that need to be referred to the Legal Office at Headquarters, particularly those relating to UNDP regulations and rules or corporate issues. However, there are also legal matters that could be better addressed by local lawyers who have full knowledge and understanding of the Country's laws and their applications (e.g., labor).

By signing contract templates that were not cleared by the Legal Office and the Office of Human Resources, by making payments not specified in the contracts, by applying two sets of regulations and rules, and by circumventing local taxation practices, the Office could face legal consequences and expose itself to financial, regulatory and reputational risks.

Priority	High (Critical)
<b>Recommendation 7:</b>  The Office should improve the management of service contracts by: <ul style="list-style-type: none"> <li>(a) immediately discontinuing the issuance of certificates as a basis for exemption for VAT payments using the UNDP standard service contract template;</li> <li>(b) verifying candidates' qualifications and credentials prior to the selection and hiring of a service contract holder; and</li> <li>(c) seeking advice from the Office of Human Resources and the Office of Financial Resources Management on how to handle the pension and other social security benefits for service contract holders in the Country.</li> </ul>	
<b>Management action plan:</b>  The Office will seek advice from the Legal Office and the Office of Human Resources on the adequacy of requesting service contractors to provide invoices and/or discontinuing this practice.  On the other issues: <ul style="list-style-type: none"> <li>(a) The Office is going to request from the Regional Bureau that the template be translated into Spanish.</li> <li>(b) The Office will ensure that academic qualifications are reviewed for all service contract holders.</li> <li>(c) The Office will seek updated advice from the Office of Human Resources regarding the current practice of the pension scheme of service contractors.</li> </ul>	
<b>Estimated completion date:</b> March 2017	

## 2. Finance

### Issue 8 Weaknesses in E-banking payment process

The 'UNDP Programme and Operations Policies and Procedures' require the establishment and use of electronic banking systems as part of a bank service to be acquired by the Office to allow for EFTs between bank accounts. The EFT is processed by the UNDP Interface, a software that permits UNDP to instruct banks to pay and transfer funds from UNDP's bank account to the bank accounts of vendors or staff. For Country Offices to be able to carry out EFTs, they may establish electronic interfaces between Atlas and local banks with electronic banking capabilities after duly informing the Treasury Unit at Headquarters of these arrangements. EFT is the preferred mode of payment, whenever possible, as it is less expensive, more efficient, and eliminates the use of cheques.

According to the 'UNDP Financial Regulations and Rules' and the Internal Control Framework, two individuals authorize any disbursement, with one to verify and the other to approve payments.

The Finance Unit was composed of one Finance Analyst, one Finance/Treasury Associate, three Finance Assistants and a cashier. In order to process payments in Atlas, one of the Finance Assistants was running a paycycle every day and was selecting all approved vouchers to be included in the paycycle without verifying the relevant supporting documents. Then, all information from the paycycle was being downloaded from Atlas in a "text format file" (not password protected or encrypted) and stored in the share-drive. This text file was then converted using a locally developed application to make it compatible with the E-banking web application. Then the converted file was manually modified to change the date format from English to Spanish and eventually uploaded in the E-banking web application, this time by the Finance Associate. Since the file downloaded from Atlas was being saved in a "text format file" and in a share drive, all the information on it, such as the vendor name, bank account number, amount to be paid, were all exposed to manipulation or modification during the conversion process.

To ensure that all the information in Atlas and E-banking application were the same, a print out of payments from the locally developed application, rather than from Atlas, was compared to the uploaded information in the E-banking web application. Consequently, the original information downloaded from Atlas was not verified against the information in the actual EFT payments. Additionally, the file compared showed details of transactions summarized by the total number and value. One missing control was the lack of review of bank account numbers on both documents in order to ensure that no unauthorized changes were made prior to actual payments.

Finally, the Finance Analyst who also acted as a Disbursing Officer reviewed the vouchers to be paid and approved payments online, which was contrary to the requirement of segregating disbursing and approving functions.

Regarding access to the E-banking web application, the following was observed:

- The Finance Analyst was the only one who had the approver right to release payments online, which was not aligned with the Internal Control Framework that required two approvers.
- The Operations Manager, who had the administrator role of the E-banking web application, was able to modify user profiles online without any other approval required.
- Two bank signatories did not have access to the E-banking web application.

In addition, the E-banking application used by the Office was not approved by UNDP Treasury Unit.

Weak controls in processing payments and making disbursements might lead to incorrect accounting and incorrect payments, which may result in the loss of funds and may lead to errors or potential fraud going undetected.

<b>Priority</b>	High (Critical)
<b>Recommendation 8:</b>  The Office should strengthen the internal controls over payments and minimize business risks by: <ul style="list-style-type: none"> <li>(a) selecting and processing payments in Atlas for which adequate and valid supporting documentation supporting payments exists and comparing Atlas payment information with the E-banking web application before authorizing the bank to release the payments;</li> <li>(b) developing an automated application to interface Atlas to the E-banking web application to eliminate the manual conversion of information in these systems and seeking approval of the E-banking application from the Treasury Unit at Headquarters; and</li> <li>(c) establishing two individuals with approving rights to jointly approve online payments and providing online access to the application for all authorized bank signatories.</li> </ul>	
<b>Management action plan:</b> <ul style="list-style-type: none"> <li>▪ The Office will review that all physical invoices exist at the moment of running the paycycle.</li> <li>▪ The Office has informed IT of this issue and IT will proceed to adjust the system in order to avoid manual conversion of information.</li> <li>▪ Before authorizing payments in E-banking web applications, all payments are compared with vouchers issued in Atlas.</li> <li>▪ The Office has filled the corresponding forms to establish two approvers for payment release.</li> <li>▪ The Office has filled the corresponding forms to ensure that change of user profiles is approved by two administrators.</li> <li>▪ The online access to the E-banking web applications for the Country Director has been requested.</li> <li>▪ The Office will handle the approval of the E-banking application with Treasury at Headquarters.</li> </ul> <p><b>Estimated completion date:</b> June 2017</p>	
<b>OAI Response</b>  OAI acknowledges the action taken by management; this will be reviewed at a later stage as part of the standard desk follow-up process of OAI.	

#### **Issue 9**      Payments to individual consultants processed outside of Atlas system

Transparency of accurate and full information is a key principle towards accountability. UNDP recognizes that there is a positive correlation between a high level of transparency through information sharing and proper accounting, and public participation in UNDP supported development activities.

The Office processed payments to consultants hired by NIM projects as part of the support services provided to those projects. These contracts and related payments were managed through a locally developed computer application. Once a month, payment information was downloaded from this application and uploaded in the E-

banking web application. However, the total amount paid for the month was entered as a single transaction in Atlas under a generic name of a vendor identified with the project number. As a result, tracing the payments to individual consultants in Atlas was not possible.

During the audit period, there were 12 projects using this modality that comprised of 282 contractors. The total amount paid and recorded in the locally developed system was estimated at \$1.6 million, with no traceability in Atlas. As such, it could not be determined which consultant was being paid and for which project. In addition, when comparing information contained in the locally developed application with Atlas, it was observed that for the period covered in the audit, 62 contractors had also received payments amounting to \$480,000 for services processed and paid through Atlas and not linked to the contracts managed through the locally developed application. It could not be ascertained whether the 62 contractors paid through Atlas were working for the same project or for different projects.

Lack of transparency in payment information might compromise UNDP's accountability.

<b>Priority</b>	High (Critical)
<b>Recommendation 9:</b>	
The Office should process all payments through Atlas and identify the specific vendor and the project for each and every payment transaction.	
<b>Management action plan:</b>	
The Office will avoid the use of generic vendors in order to implement this recommendation. Payments to consultants will be processed in Atlas.	
<b>Estimated completion date:</b> June 2017	

#### **Issue 10**      Deficiencies in management of vendor accounts

UNDP's enterprise resource planning system, Atlas, is used to record information and process payments. An integral part of the payment process is to ensure that vendors meet UNDP requirements. The 'UNDP Programme and Operations Policies and Procedures' state that prior to the creation of a vendor record, supporting documentation must be obtained that indicates a bona fide business relationship between UNDP and the vendor. Key supporting documents include originals or certified copies of documents showing the complete name, address and banking details of the vendor, which should be duly signed by an authorized company official, as appropriate. Should such signed documents not be available prior to approval, the approving officer must obtain satisfactory evidence that the details are authentic. Furthermore, if the vendor is unable to provide a letterhead for its own business entity, a certification of bank account details from the vendor's bank is required.

In addition, as per the Internal Control Framework, to create a vendor in the system, two individuals need to be involved: one for creating the vendor and another one for approving it. The vendor approver role is performed by a UNDP staff member only, who authorizes the establishment of a vendor in Atlas and this role must be specifically assigned by the head of the office. This role should be restricted to a minimum of two staff members in order to reduce the risk of unauthorized or incorrect changes to sensitive vendor data.

The current process of vendor creation carried out by the Office consists of requesting vendors to fill in a form containing vendor data (e.g. name, address, preferred payment modality, bank account number and bank name). However, no supporting documents were requested from these vendors and attached to the vendors' forms to certify the accuracy of the data, such as an invoice or certified bank account number, contrary to the provisions of the 'UNDP Programme and Operations Policies and Procedures'.

There were six staff members working in the Finance Unit, along with the Operations Manager, who all had the authority to create vendors in the E-banking web application without requesting prior approval, contrary to the Internal Control Framework. The audit team identified that 5,537 vendors created in the E-banking web application while there were 3,683 vendors registered in Atlas.

Generic vendors were identified during the review of payments, as discussed in Issue 9. The Office used vendor names like "Local staff" or "UNDP proyectos especiales" in processing payments and granting advances to project personnel and booking the expenses in Atlas. During the audit period, there were expenses entered in Atlas to these vendors amounting to \$23.6 million out of total payments amounting to \$61.6 million (approximately 38 percent of payments), which made financial analysis and monitoring cumbersome and weakened controls.

Improperly created vendor profiles may result in fictitious vendors being included in UNDP's system and inaccurate accounting and reporting of expenditures. Without verifying vendors' bank information, there was no assurance that all payments processed were made to the correct vendor and/or account.

<b>Priority</b>	High (Critical)
<b>Recommendation 10:</b>  The Office should strengthen vendor management by: <ul style="list-style-type: none"> <li>(a) requiring submission of supporting documentation for vendor profile creation and performing data review of vendors' information in Atlas to ensure that information is accurate, unique and complete;</li> <li>(b) reviewing the process of creating vendors in the E-banking web application by restricting access to do so and by having independent approval of new vendors created; and</li> <li>(c) aligning Atlas vendors' information to the information in the E-banking system.</li> </ul>	
<b>Management action plan:</b> <ul style="list-style-type: none"> <li>▪ The Office will proceed to request vendor's bank information as supporting documents.</li> <li>▪ The Procurement Unit will be in charge of recording vendors in Atlas and banking information in the E-banking web application.</li> <li>▪ The Procurement Unit will be in charge of aligning Atlas vendors' with the E-banking system</li> <li>▪ Generic vendors for salaries will no longer be used.</li> </ul>	
<b>Estimated completion date:</b> June 2017	

#### **Issue 11**      Incorrect use of cash advances

According to the 'UNDP Programme and Operations Policies and Procedures', the approval of a request for a cash advance by an implementing partner for a particular project is subject to the verification by the Office that

at least 80 percent of the previous advance and 100 percent of all earlier advances granted have been liquidated. In managing funds, NIM projects can choose either opening a dedicated bank account to process payments for project activities or request the Office to make payments on their behalf.

Projects are allowed to make cash payments when carrying out project activities in remote areas due to the lack of banking facilities or for specific project arrangements. A Project Cash Advance is a one-time advance issued to a custodian for a specific one-time project activity. Typically, the one-time project activity involves conducting workshops, training seminars or conferences relating to certain projects that take place in remote locations. The duration for such activities ranges from two days to two weeks. Actual expenses incurred must be fully accounted for and the cash advance liquidated within seven days after the last day of the one-time project activity.

A Petty Cash Fund is an amount of cash securely kept in the cashier's office and used to make cash payments for minor miscellaneous items like stamps, for which it is not practical or possible to make payments by check or EFT.

The audit disclosed the following deficiencies in the management of cash advances and petty cash funds:

#### Advances to national implementing partners

The Office granted advances to implementing partners on some NIM projects without having at least 80 percent of the previous advance liquidated. This was done to accommodate projects quarterly needs for cash, and requiring projects to account for their expenses and liquidate advances at the end of each quarter only. This situation led to the granting of advances without liquidation of prior advances. In fact, OAI found \$80,000 in outstanding balances of cash that were yet to be liquidated and were overdue from four to six months.

In addition, FACE forms were incorrectly used because the standard form was modified by the Office. Only the amount of funds that were being requested were reflected in the form, omitting information on prior advances and the balances that remained outstanding and awaiting justification and accounting for the relevant expenses by implementing partners.

#### Project Cash Advances

The Office was incorrectly using this type of advance to effect payments for some Office activities. For instance, Project Cash Advances were granted to the head of general administration to defray building maintenance expenses. This modality was also used to pay for taxi fares and meals for personnel working late in the Office. According to the Office, there was an understanding that, if a staff member stayed in the Office late in the evening (after 21.00 hours), he or she was entitled to such benefits. It was also noted that the taxi fares reimbursed were based on a self-declaration invoice instead of a taxi invoice.

#### Excessive use of petty cash

The review of petty cash expenses showed that the Office used these funds to pay for activities related to DIM projects (e.g., catering services for meetings). Instead, activities of DIM projects should have been planned in advance with the necessary cash arrangements.

Outstanding cash advances for an extended period could lead to the risks that they may not be used for the purposes for which they were granted and incorrect recording of expenditures if they had actually been spent

but not reported. In addition, non-compliance with cash management principles may lead to financial mismanagement or losses and could have a negative impact on the Office's reputation and finances.

Priority	Medium (Important)
<b>Recommendation 11:</b>  The Office should strengthen the management of cash advances by: <ul style="list-style-type: none"> <li>(a) revisiting the procedure for granting cash advances in line with project implementation modality and appropriate use of funds and reviewing liquidation processes for cash advances;</li> <li>(b) properly using the standard FACE form templates; and</li> <li>(c) limiting the use of petty cash funds to minor expenditures on directly implemented projects.</li> </ul>	
<b>Management action plan:</b> <ul style="list-style-type: none"> <li>▪ National implementation modality: The Office will ensure that 80 percent of previous advances have been recorded in Atlas before giving another advance and 100 percent of all earlier advances have been liquidated.</li> <li>▪ Project Cash Advances (Account 16108): The Office will discontinue granting these kinds of advances to the head of general administration.</li> <li>▪ The Office will coordinate with Headquarters the authorization for changes made to the FACE form.</li> <li>▪ The Office will review this procedure with directly implemented projects.</li> </ul>	
<b>Estimated completion date:</b> June 2017	



## Definitions of audit terms - ratings and priorities

### A. AUDIT RATINGS

- **Satisfactory** Internal controls, governance and risk management processes were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.
- **Partially Satisfactory** Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.
- **Unsatisfactory** Internal controls, governance and risk management processes were either not established or not functioning well. The issues were such that the achievement of the overall objectives of the audited entity could be seriously compromised.

### B. PRIORITIES OF AUDIT RECOMMENDATIONS

- **High (Critical)** Prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP.
- **Medium (Important)** Action is required to ensure that UNDP is not exposed to risks that are considered moderate. Failure to take action could contribute to negative consequences for UNDP.
- **Low** Action is desirable and should result in enhanced control or better value for money. Low priority recommendations, if any, are dealt with by the audit team directly with the Office management, either during the exit meeting or through a separate memo subsequent to the fieldwork. Therefore, low priority recommendations are not included in this report.