



CONSOLIDATED REPORT

ON THE AUDITS

OF SUB-RECIPIENTS OF GRANTS FROM THE GLOBAL FUND

MANAGED BY UNDP

(FISCAL YEAR 2016)

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Consolidated Report on the Audits of Sub-recipients of Grants from the Global Fund (FY2016) Executive Summary

Background

In July 2017, the Office of Audit and Investigations (OAI) concluded the review and analysis of audit reports of projects implemented by non-governmental organizations or government institutions that were Sub-recipients (SRs) of grants from the Global Fund for the fiscal year 2016 (FY2016). The main objective of these audits is to provide UNDP with assurance that resources have been used in accordance with the SR agreements and relevant regulations and rules, policies and procedures of UNDP. This report presents the consolidated results of these SRs audits.

Purpose and scope of the review

The OAI review aimed to: (a) analyse the distribution of external audit firms' audit opinions; (b) highlight the audit areas under which the internal controls of the SRs were assessed as weak; (c) identify common audit issues; and (d) determine the implementation status of the prior year audit recommendations. The review covered 65 audit reports for FY2016 that had been uploaded by Country Offices in the Comprehensive Audit and Recommendations Database System (CARDS) of OAI.

These 65 audit reports pertained to 17 projects funded by the Global Fund and to 58 SRs in 12 of the 23 countries and 1 of the 5 regional programmes for which UNDP was the Principal Recipient. The reports covered FY2016 project expenses totalling \$46 million, equivalent to 46 percent of the overall UNDP/Global Fund SR expenses of \$100 million incurred in 2016.

Results of the review

The auditors have expressed unmodified audit opinions in all the audit reports and over the total audited expenses.

With respect to the auditors' assessment of internal controls, the number of unsatisfactory ratings was low. The areas where the auditors found unsatisfactory internal controls related mostly to financial management, cash management, and SR activities management.

The external audit firms raised a total of 165 audit observations in FY2016, categorized by risk severity and by audit area, as follows:

- Risk severity: The 165 audit observations were categorized as: 19 (12 percent) high priority; 106 (64 percent) medium priority; and 40 (24 percent) low priority.
- Audit areas: Most of the audit observations belonged to three core audit areas, namely: financial management; human resources selection and administration; and management and use of equipment/inventory, which together, accounted for 121 (73 percent) of the total 165 audit observations.

The area of financial management continued to result in the highest number of audit observations/recommendations. The most common audit issue was the lack of adequate accounting systems and controls.

Implementation of prior year audit recommendations

The external audit firms were required to review the progress achieved by the SRs in implementing the prior year's audit recommendations (FY2015) and to report on the updated "action plans" for those recommendations. OAI focused its assessment on the implementation status of the high priority recommendations. Of the 29 recommendations in FY2015 and rated as high priority, 17 (59 percent) had been implemented, and the remaining 12 (41 percent) had been withdrawn because the related projects ended in 2016.

Management action plan

The Global Fund/Health Implementation Support Team (GF/HIST) within the HIV, Health and Development Group (HHD), Bureau for Policy and Programme Support (BPPS) continued its efforts to enhance the partnership with the Global Fund, with a focus on risk management and high performance of its programmes. In 2017 a new web-based UNDP Global Fund & Health Implementation Guidance Manual was launched. This Manual provides guidance, best practices, and links to existing UNDP rules, policies and procedures, as well as Global Fund guidelines and processes for each step of the grant life cycle, including a dedicated section on SR management. The target users of this publicly accessible web-based Manual are the UNDP Country Offices managing Global Fund grants and their government and civil society organization partners.

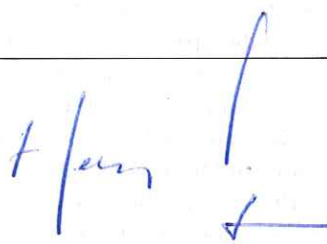
The SR section of the Manual provides guidance and best practices in managing SRs throughout the grant life cycle, with sections on selection, capacity assessment and engagement with SRs. This includes monitoring, reporting and managing risks relating to SRs. The area of SR management by UNDP Country Offices acting as Principal Recipients significantly improved since 2014. There were no audit recommendations in 2016.

The SR grant agreement templates, tools and guidelines were also amended by GF/HIST to reflect the new Framework Agreement signed with the Global Fund in October 2016. Unlike the old framework that required the Global Fund's approval for asset transfer at the end of the grant, the Framework Agreement clarifies that assets are managed, disposed of and transferred to other entities in accordance with UNDP rules. This extends to assets procured by SRs.

The GF/HIST during 2017, provided support on financial management of SRs to a number of Country Offices, including Afghanistan, Africa Regional, Angola, Belize, Chad, Guinea-Bissau, Jamaica, Mali, Sao Tome and Principe, South Sudan and Western Pacific Regional.

Also in 2017, the GF/HIST with the support of OAI established new Long-Term Agreements with four audit firms in the amount of \$2.1 million for a three-year period to complete the SR audits for GF funded programmes. The Terms of Reference were enhanced to include lessons learnt from the past five years. A joint GF/HIST – OAI induction webinar was held in November 2017 for the newly recruited audit firms.

In 2018, the GF/HIST plans to enhance capacity of Country Offices for SR management in the area of record keeping, pilot the annual asset review to address proper tagging of assets, develop policy guidance for the insurance of assets and continue the targeted SR financial management support to Country Offices.



Helge S. Osttveiten
Director
Office of Audit and Investigations

1. Introduction

The Global Fund is a partnership organization designed to accelerate the end of AIDS, tuberculosis and malaria as epidemics. The partnership is built with government, civil society and people affected by the diseases, which raises and disburses grant funds to support programmes in countries in need. As Principal Recipient, UNDP is accountable for the proper use of grant funds and the implementation of projects in recipient countries. UNDP may appoint Sub-recipients (SRs) to implement part of the project activities that would otherwise be carried out by UNDP. The SR can be a governmental entity, a United Nations entity, or a non-governmental organization. SRs that are governmental entities or non-governmental organizations are required to be audited by external audit firms pursuant to the UNDP procedures for audits of projects under national implementation modality. The total UNDP/Global Fund expenses incurred by both Principal Recipients and SRs in 2016 were \$396 million. Of these, project expenses incurred by SRs under the non-governmental organization/national implementation modality amounted to \$100 million or 25 percent. The FY2016 audits covered \$46 million of the \$100 million of expenses incurred by SRs.

2. OAI role in Global Fund Sub-recipient audits

Each year, UNDP Country Offices that are Principal Recipients advise OAI of the SRs to be audited as part of their annual audit plans. Each SR selected is required to undergo an audit of its expenses, cash, and assets statements, and an assessment of its internal controls if the project will be continued. The selection and audit of the SRs must be completed based on the criteria and the deadline established by OAI. The Bureau for Policy and Programme Support (BPPS) Global Fund Health/Implementation Support Team holds Long-Term Agreements with external audit firms to improve the consistency and quality of the SR audits. The contracting for the audit and acceptance of the audit reports is a process owned by Country Offices. The audit reports of SRs are first submitted to the Country Office and once accepted, they are to be submitted to OAI for review. The submission of audit reports to OAI is done by the Country Office uploading the audit reports and specific contents into the Comprehensive Audit Report Database (CARDS) that is managed by OAI. OAI checks the quality of the data and information uploaded to CARDS and assesses the quality of the scope of work as well as the reported results of the audit work.

When requested by the Global Fund, the Country Office may provide the audit report of the SRs to the Global Fund or its representative (the Local Fund Agent).

3. Review of Global Fund Sub-recipient audits in FY2016

In line with OAI criteria for the selection of SRs to be audited, 11 countries (Angola, Belize, Bolivia, Djibouti, Guinea-Bissau, Iraq, Kyrgyzstan, Panama, Sao Tome and Principe, Syrian Arab Republic, and Turkmenistan) and 4 regional programmes (Multi-country Americas, Multi-country Western Pacific, Multi-country Western Pacific/Vanuatu, and Africa Regional) did not require audits, specifically where:

- (a) the expenses incurred by the SRs did not meet the audit threshold or did not meet the Once-in-Lifetime criteria; or
- (b) UNDP was directly implementing projects without partnering with SRs.

The analysis of the audit opinions and audit observations of the 65 SR audit reports showed the following:

Distribution of audit opinions

The external audit firms are required to certify, express an opinion, and, if applicable, quantify the Net Financial Misstatement (NFM) on three types of financial statements, namely:

- (a) the Certification on UNDP Statement of Expenses/Combined Delivery Report for the period 1 January to 31 December 2016;
- (b) the Certification on Statement of Cash Position as at 31 December 2016; and
- (c) the Certification on Statement of Assets and Equipment as at 31 December 2016.

The distribution of audit opinions by country and the definition of the types of audit opinions are detailed in Annex 1 and 2, respectively.

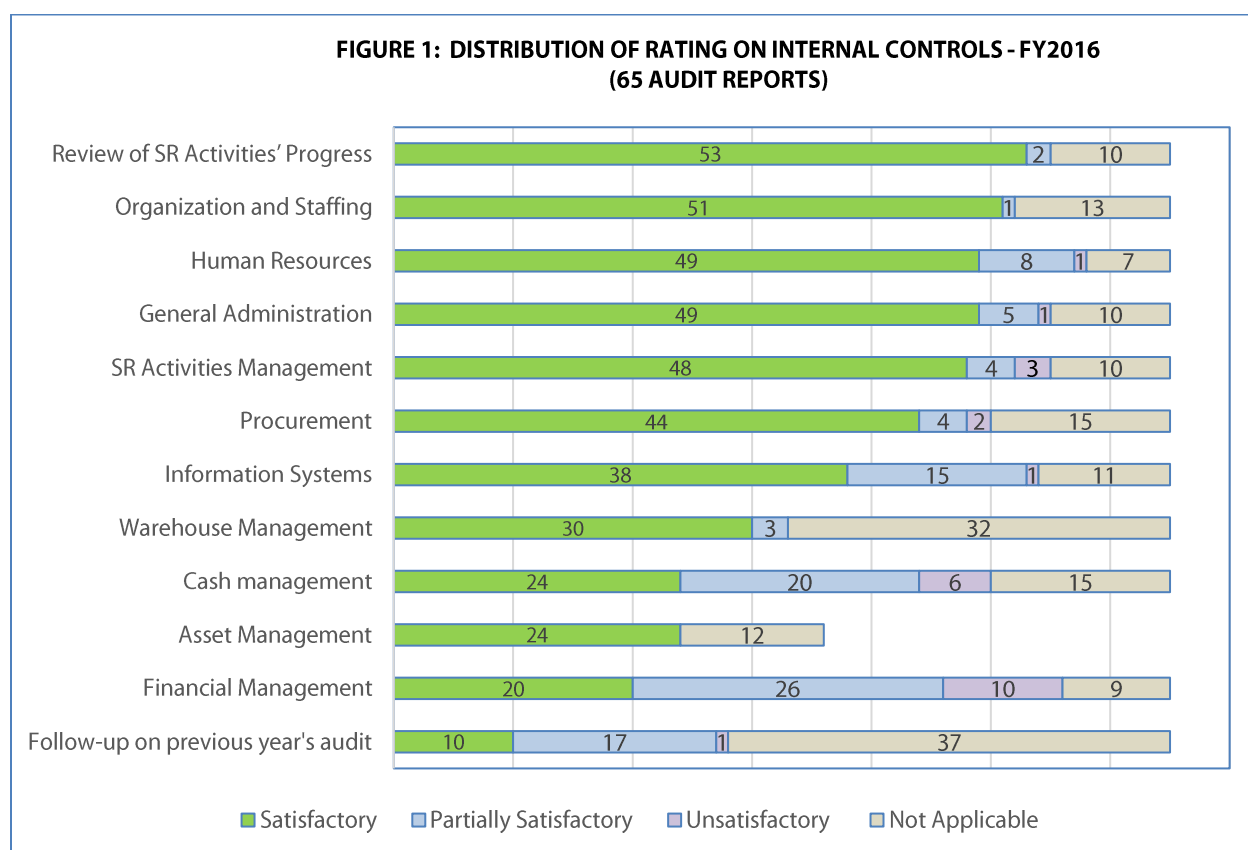
In FY2016, the auditors expressed unmodified opinions in all the audit reports and over the entire \$46 million of expenses audited. There were no reports with modified audit opinions, i.e., no NFM has been reported.

Rating of Internal Controls

The external auditors are also required to provide ratings of the internal controls of SRs according to the areas defined in the Terms of Reference. For FY2016, the review of SR found that satisfactory internal controls were mostly found in organization and staffing, human resources, and general administration.

While the number of unsatisfactory ratings was very low (refer to Figure 1 below), the areas where the auditors found unsatisfactory internal controls were related to financial management, cash management, and SR activities management.

Figure 1 presents the distribution of ratings on internal controls by audit area reviewed by OAI for the 58 SRs audited:



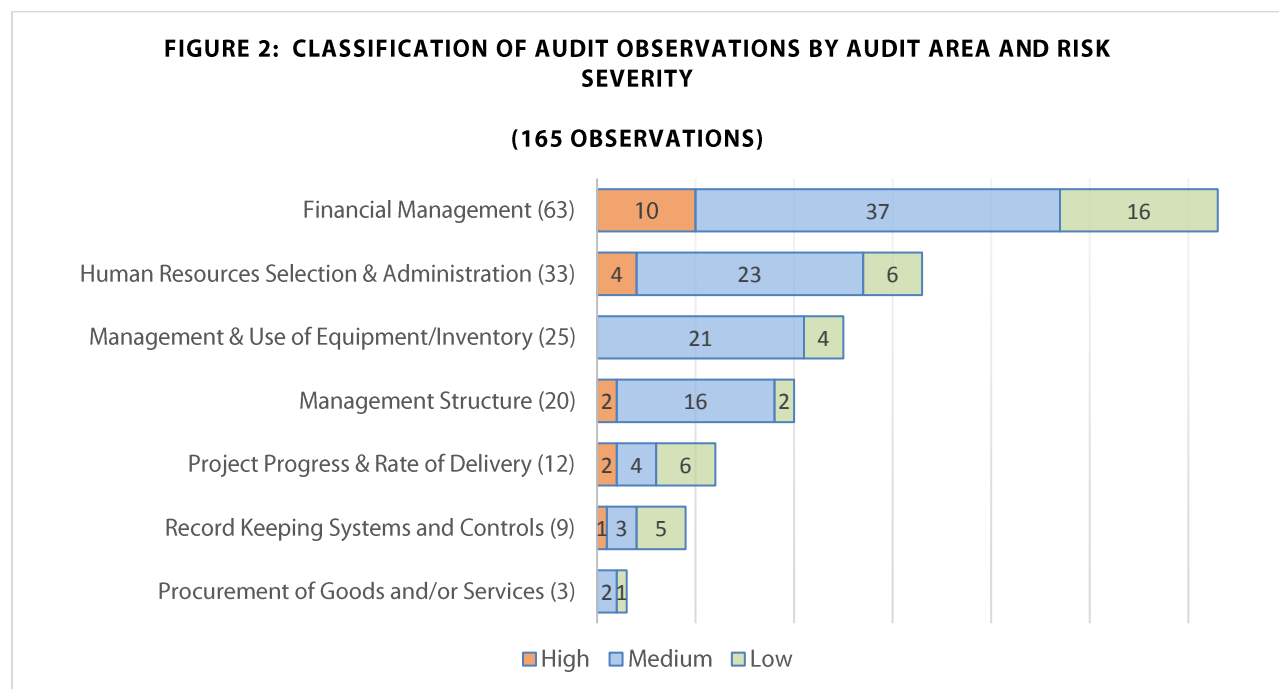
Source: CARDS

Audit observations and recommendations

For each SR audit, the auditors are required to issue a management letter with the internal control weaknesses noted. The management letter includes the audit observations and recommendations, categorizes the nature of audit observations by risk severity, and classifies the audit observations and recommendations by audit area. The audit firms raised 165 observations and recommendations in the 65 SR audit reports for FY2016. The reports were examined by OAI and the distribution of the audit observations and recommendations by risk severity and by audit area were as follows:

- **Risk severity:** The audit firms classified the audit observations and recommendations in three categories: high, medium, and low. The 165 audit observations comprised of 19 (12 percent) high priority; 106 (64 percent) medium priority; and 40 (24 percent) low priority.
- **Audit areas:** The nature of audit observations and recommendations are categorized into seven audit areas as pre-determined by OAI in CARDS, namely financial management, human resources selection and administration, management and use of equipment/inventory, management structure, procurement of goods and/or services, project progress and rate of delivery, and record keeping systems and controls.

The distribution by audit area and risk severity for the 165 audit observations and recommendations is shown in Figure 2 below.



Source: CARDS

Three core audit areas, namely (a) financial management, (b) human resources selection and administration, and (c) management and use of equipment/inventory accounted for 121 audit observations or 73 percent of total audit observations. With respect to financial management, the most common audit issue relates to the lack of adequate accounting systems and controls. Regarding human resources selection and administration, the issues were mainly on poor management of contracts, salaries, and performance evaluations. Regarding management and use of equipment, issues were mainly on the lack of proper inventory systems.

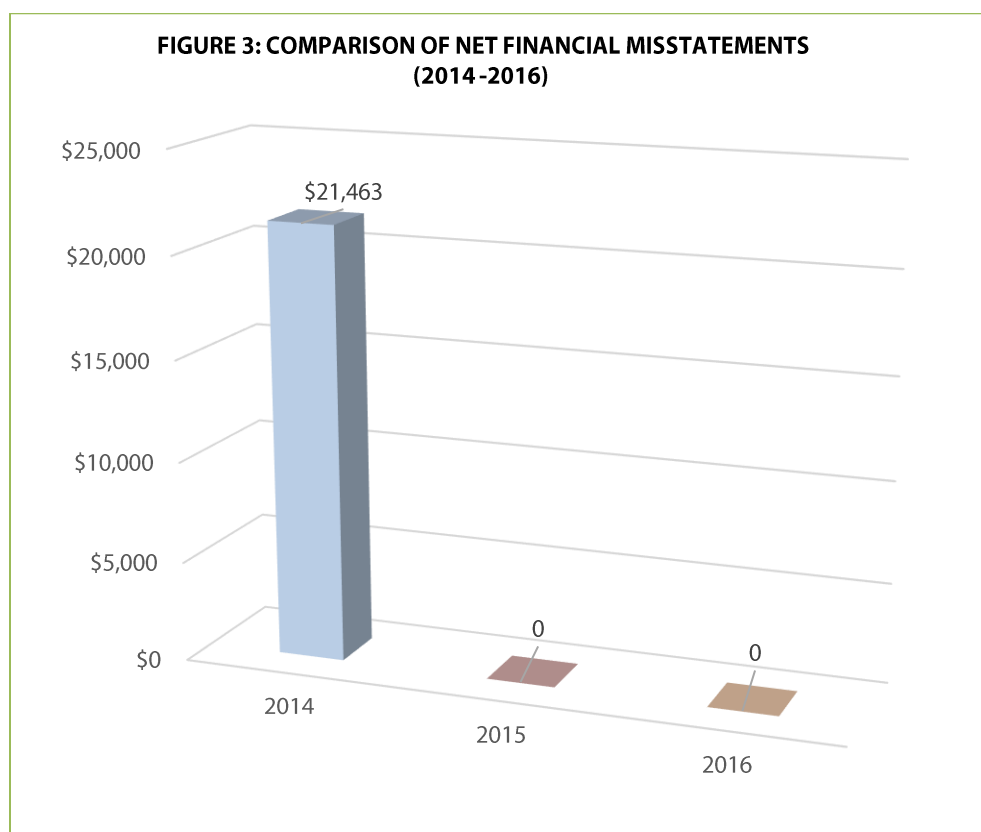
4. Implementation of prior year audit recommendations

The external audit firms were required to review the progress achieved by the SRs in implementing the prior year's audit recommendations (FY2015) and to report on the updated "action plans" (intended management actions to address the observations) for those recommendations. The Country Offices were required to upload and monitor the implementation status of the recommendations in CARDS.

OAI focused its assessment on the implementation status of high priority recommendations. Of the 29 high priority FY2015 recommendations, the implementation status as of the end of 2016 was as follows: 17 (59 percent) had been implemented and the remaining 12 (41 percent) were withdrawn since the related projects were already closed.

5. Net Financial Misstatement (NFM)

The auditors expressed unmodified audit opinions in all the audit reports and over the total FY2016 audited expenses. This is a continuous improvement as the auditors had also expressed unmodified audit opinions in the FY2015 audit reports while there were modified opinions in the FY2014 audit reports representing 0.6 percent of the audited expenses with a NFM of \$21,463.



Source: CARDS

Annex 1: Distribution of audit opinions in the Global Fund Sub-recipient audit reports for FY2016

Country Office/ Programme	Number of SRs audited	Audited SR Expenses (in U.S. dollars)	Adverse		Qualified		Unmodified		NFM Current Year
			# of SRs	Amount Audited	# of SRs	Amount Audited	# of SRs	Amount Audited	
Afghanistan	23	3,929,546	-	-	-	-	23	3,929,546	-
Chad *	1	-	-	-	-	-	1	-	-
Cuba	3	4,155,513	-	-	-	-	3	4,155,513	-
Haiti	5	570,512	-	-	-	-	5	570,512	-
Iran	1	419,297	-	-	-	-	1	419,297	-
Mali	5	296,401	-	-	-	-	5	296,401	-
Multi Country South Asia (MSA)	1	1,006,161	-	-	-	-	1	1,006,161	-
South Sudan	1	896,395	-	-	-	-	1	896,395	-
Sudan	2	1,771,789	-	-	-	-	2	1,771,789	-
Tajikistan	4	1,007,896	-	-	-	-	4	1,007,896	-
Uzbekistan	1	1,011,500	-	-	-	-	1	1,011,500	-
Zambia	1	515,217	-	-	-	-	1	515,217	-
Zimbabwe	10	29,995,026	-	-	-	-	10	29,995,026	-
TOTAL	58	45,575,253	-	-	-	-	58	45,575,253	-

* In Chad, the Country Office operates under direct implementation for the SRs of Global Fund grants. No cash is transferred to the SRs. Therefore, only the management letter discussing the internal controls of the SRs was required for the audit exercise.

Annex 2: Definition of External Audit Opinions

Unmodified (Clean) Opinion (ISA 700)

An unmodified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the applicable financial reporting framework.

An unmodified opinion indicates implicitly that any changes in accounting policies or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.

Qualified Opinion (ISA 705)

The auditor expresses a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Disclaimer of opinion (ISA 705)

The auditor disclaims an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Adverse Opinion (ISA 705)

The auditor shall express an adverse opinion when, having obtained sufficient appropriate audit evidence, s/he concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.