UNITED NATIONS DEVELOPMENT PROGRAMME

Office of Audit and Investigations

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CONSOLIDATED REPORT

ON THE AUDITS

OF SUB-RECIPIENTS OF GRANTS FROM

THE GLOBAL FUND TO FIGHT AIDS, TUBERCULOSIS AND MALARIA

MANAGED BY UNDP

(FISCAL YEAR 2012)

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Executive Summary

Background

In December 2013, the Office of Audit and Investigations (OAI) concluded the review and analyses of audit reports of projects implemented by non-governmental organizations or government institutions that were Sub-recipients (SRs) of grants from the Global Fund to Fight AIDS, Tuberculosis and Malaria (Global Fund). UNDP was the Principal Recipient of 53 Global Fund grants in 26 countries, totalling $1.7 billion as of December 2013. Except for United Nations entities, organizations engaged as SRs of those grants are required to be audited by external audit firms, pursuant to the UNDP procedures for audits of projects under the non-governmental organization/national implementation modality. The main objective of those 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.

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 32 audit reports for fiscal year (FY) 2012 that had been uploaded by Country Offices in the Comprehensive Audit and Recommendations Database System (CARDS) of OAI.

These 32 audit reports pertained to 31 projects funded by the Global Fund in 18 countries where UNDP was the Principal Recipient and which met the required audit criteria set by OAI. The reports covered FY 2012 project expenses totalling $71.6 million, equivalent to 70 percent of the overall UNDP/Global Fund SR expenses of $102.5 million incurred in 2012.[1] In terms of distribution, $50 million (70 percent) of the expenses audited related to grants managed under the Additional Safeguard Policy.[2]

Results of the review

Of the $71.6 million in expenses audited, $58 million (81 percent) had unqualified audit opinions, $11.5 million (16 percent) had qualified audit opinions, and $2.1 million (3 percent) had an adverse opinion. Those with modified (qualified and adverse) audit opinions had a net financial impact (NFI) of about $3 million, representing 4 percent of the total audited expenses. By comparison, in 2011, the NFI was about $0.4 million, equivalent to 0.41 percent of the audited expenses.

Of concern in 2012 is the programme in Chad that received an adverse opinion with an NFI of $2.1 million. In addition, the programme in Haiti received qualified audit opinions in the last two consecutive years.

[1] The figure is based on the total amount recorded under the Government/NGO column of the Atlas-generated CDR.
[2] The Additional Safeguard Policy is a range of tools established by the Global Fund as a result of its risk management processes.

The external audit firms raised a total of 431 audit observations in FY 2012, categorized by risk severity and by audit area, as follows:

- Risk severity: The 431 audit observations were categorized as: 140 (32 percent) high priority; 193 (45 percent) medium priority; and 98 (23 percent) low priority.

- Audit areas: The audit observations were primarily categorized in three core audit areas, namely: financial management; human resources selection and administration; and project progress and rate of delivery, which together, accounted for 307 (71 percent) of the total 431 audit observations.

Inadequate documentation in support of expenses, errors in recording transactions, lack of adequate accounting or project management software and lack of reconciliation between accounting records/bank statements to cash in hand contributed to the sub-optimal financial management capacity of many of the SRs.

Implementation of audit recommendations

The external audit firms were required to review the progress achieved by the SRs in implementing the prior year's audit recommendations (FY 2011) 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 81 recommendations, the implementation status in 2012 was as follows: 58 (72 percent) had been implemented, 3 (4 percent) were in progress, 12 (15 percent) had not been implemented, and 8 (10 percent) were no longer applicable. This marked a significant improvement over FY 2010 for which 37 percent of high priority audit recommendations had been implemented in 2011.

Management action plan

Recognizing the need for closer monitoring and oversight of SR financial management, the Terms of Reference for the audits of projects under national implementation modality had been strengthened for financial management and expanded to also include review of internal controls and processes. Starting with the FY 2012 audit, the Bureau for Development Policy Global Fund Partnership Team engaged in long-term agreements with external audit firms for SR audits to improve the consistency and quality of the audit reports.

To strengthen SR management, the Team was also developing an on-line application to map SRs and Sub-sub-recipients so that Country Offices can have an accurate picture of grant implementation arrangements, flow of funds and inventory of health products. The development and dissemination of best-practice tools for each stage of the grant life cycle, including a financial management training package will be finalized and included in the UNDP Capacity Development Toolkit. Finally, those SRs identified through the FYs 2012 and 2013 audit process as having sub-optimal management capacities would be targeted for dedicated capacity building activities.

Helge S. Osttveiten
Director
Office of Audit and Investigations

1. Introduction

The Global Fund is a global public-private partnership dedicated to attracting and disbursing resources to prevent and treat HIV/AIDS, tuberculosis, and malaria. As of December 2013, UNDP was the Principal Recipient of 53 Global Fund grants in 26 countries totalling $1.7 billion. As Principal Recipient, UNDP is accountable for the proper use of grant funds and the implementation of projects in recipient countries. UNDP may appoint an SR to implement part of the project activities that would otherwise be carried out by UNDP. An 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 increased from $324 million in 2011 to $368 million in 2012. In 2012, project expenses incurred by SRs audited under the non-governmental organization/national implementation modality audit process amounted to $72 million, with $50 million in Additional Safeguard Policy countries.

2. OAI role in the non-governmental organization/national implementation modality audits

The main objective of a non-governmental organization/national implementation modality audit is to provide UNDP with assurance that resources have been used properly and that internal controls are effective. Each year, 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. The audit of the SR's expenses must be completed by the deadline established by OAI. Starting with the FY 2012 audit, the Bureau for Development Policy Global Fund Partnership Team engaged in long-term agreements with external audit firms to improve the consistency and quality of the SR audit reports. The audit reports of SRs are to be submitted to OAI for review. 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).

The submission, tracking and analysis of these audit reports and action plans is supported by a dedicated module in CARDS.

3. Review of audits of Global Fund Sub-recipients in FY 2012

In line with OAI criteria for the selection of SRs to audit, eight countries did not require audits, specifically where:

(a) UNDP was directly implementing projects without partnering with SRs (Angola, Sudan);
(b) the SRs were United Nations entities (Iraq); and
(c) the expenses incurred by the SRs did not meet the audit threshold (Sao Tome and Principe, South Sudan, PAPP, Syria and Turkmenistan).

The analysis of the audit opinions and audit observations of the 32 SR audit reports showed the following:

<u>Distribution of audit opinions</u>

The external audit firm was required to certify, express an opinion, and quantify the NFI 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 2012;

(b) the Certification on Statement of Cash Position as at 31 December 2012; and

(c) the Certification on Statement of Assets and Equipment as at 31 December 2012.

The distribution of audit opinions by country, as well as the definition of the type of external audit opinions is detailed in Annex 1 and 2, respectively.

In FY 2012, of the $71.6 million audited expenses, $58 million (81 percent) had unqualified audit opinions, $11.5 million (16 percent) had qualified audit opinions (Bolivia, Haiti and Kyrgyzstan), and $2.1 million (3 percent) had an adverse opinion (Chad). The NFI of the qualified and adverse opinions was about $3 million, representing 4 percent of the total audited expenses, as shown in Figure 1.

Figure 1: Net Financial Impact of the Modified Opinions on Audited Expenses

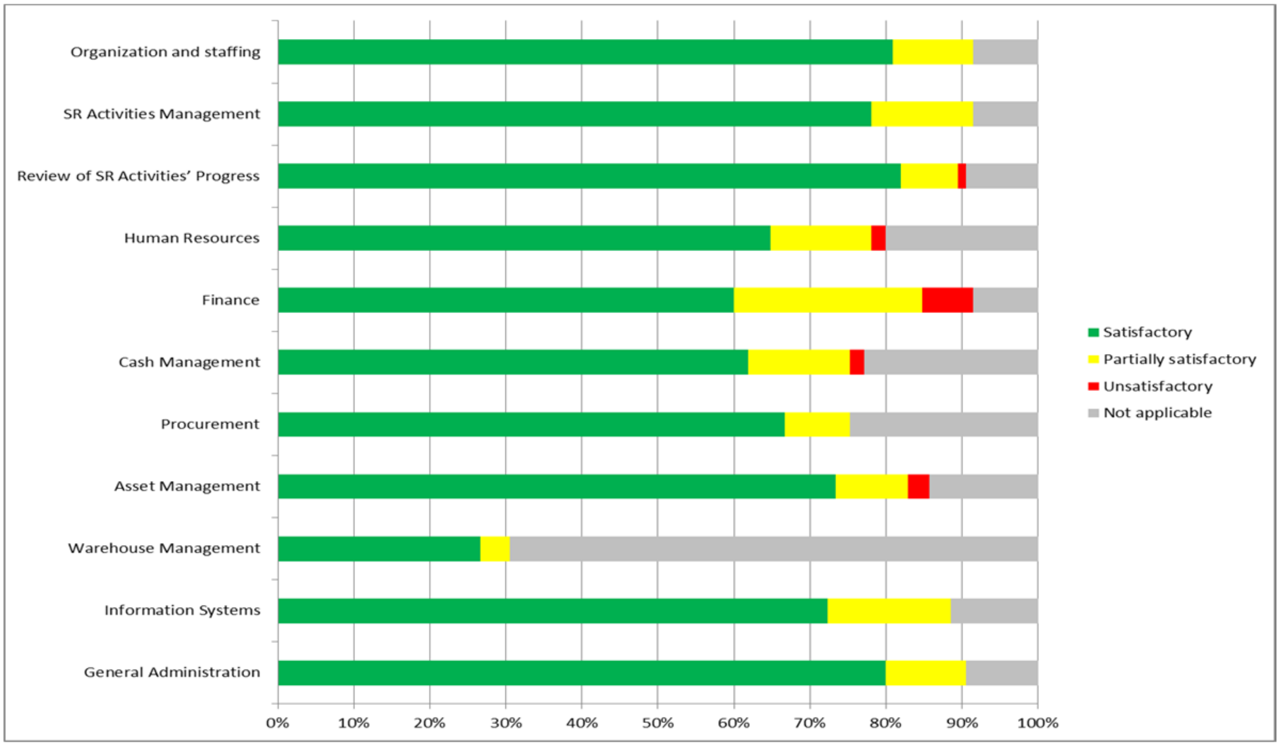
Country Office	Audited Expenses	Total CDR	Adverse		Qualified		Net Financial Impact (NFI)	NFI/audited expenses
			# Projects	Amount Audited	# Projects	Amount Audited		
Bolivia	$1,228,884	$1,228,884	0	$0	1	$1,228,884	($110,566)	9%
Chad	$2,077,340	$22,038,732	1	$2,077,340	0	$0	($2,077,340)	100%
Haiti	$8,709,428	$17,225,782	0	$0	2	$8,709,428	($248,050)	3%
Kyrgyzstan	$1,615,983	$5,237,330	0	$0	1	$1,615,983	($552,975)	34%
Other countries	$58,003,229	$207,191,759	0	$0	0	$0	-	-
Total	**$71,634,864**	**$252,922,487**	**1**	**$2,077,340**	**4**	**$11,554,295**	**($2,988,931)**	**4%**

Most NFIs were related to unsupported expenses ($2.3 million or 78 percent of the total NFI), expenses not recorded ($0.6 million or 18 percent) and incorrectly recorded expenses or advances ($0.1 million or 4 percent).

Rating of Internal Controls

For the 2013 audit exercise, ratings of key audit areas were provided. Overall, the results highlighted satisfactory controls, as highlighted in Figure 2 below.

Figure 2: Distribution of rating on Internal Controls



Areas with "unsatisfactory" ratings pertained to the following: (a) review of SR activities' progress; (b) human resources; (c) finance; (d) cash management; and (e) asset management.

Audit observations

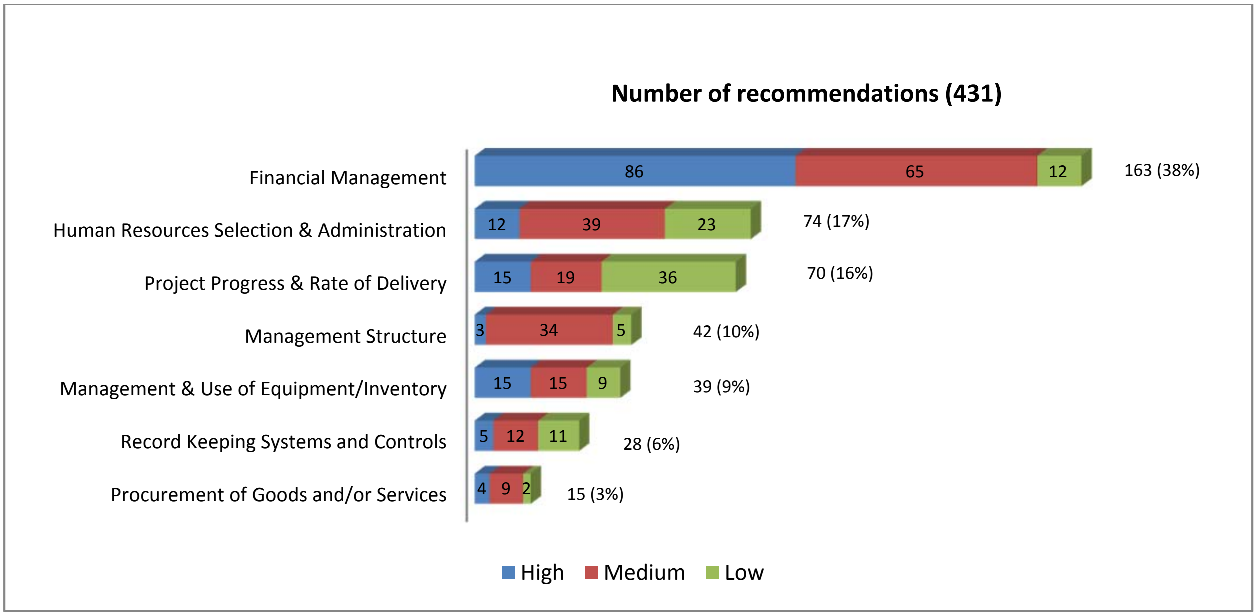
For each SR audit, the external auditors were required to describe internal control weaknesses in a management letter. The management letter included the audit observations and recommendations, categorized the nature of audit observations by risk severity, and classified the audit observations by audit areas. The external audit firms raised 431 observations in the 32 SR audit reports for FY 2012. The reports were examined by OAI and the distribution of the audit observations by risk severity and by audit area was as follows:

- Risk severity: In terms of risk severity, the external audit firms classified the audit observations in three categories, namely high, medium, or low. The 431 audit observations comprised of 140 (32 percent) categorized as high priority; 193 (45 percent) categorized as medium priority; and 98 (23 percent) categorized as low priority.

- Audit areas: The external audit firms classified the nature of audit observations according to seven audit areas, namely (a) financial management, (b) project progress and rate of delivery, (c) human resources management and administration, (d) record keeping systems and controls, (e) management and use of equipment/inventory, (f) management structure, and (g) procurement of goods and/or services.

The distribution by audit area and risk severity for the 431 audit observations is shown in Figure 3.

Figure 3: Classification of Audit Observations by Audit Area



Three core audit areas, namely (a) financial management, (b) human resources selection and administration, and (c) project progress and rate of delivery, accounted for 307 audit observations or about 71 percent. With respect to financial management, the most common issues related to inadequate documentation in support of expenses, errors in recording transactions, lack of adequate accounting or project management software and lack of reconciliation between accounting records/bank statements to cash in hand. Project management issues were primarily due to inadequate preparation of activity reports and delivery delays. Human resources issues mainly encompassed poor management of contracts and an inadequate performance evaluation system.

4. Implementation of audit recommendations

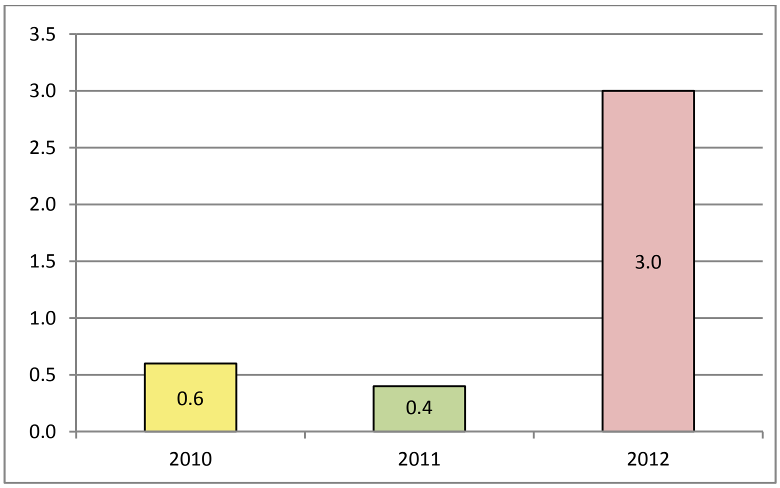
The external audit firms were required to review the progress achieved by the SRs in implementing the prior year's audit recommendations (FY 2011) and to report on the updated "action plans" (intended management actions to address the observations) for those recommendations. The Country Offices were required to upload and monitor the implementation status of the recommendations in CARDS.

OAI focused its assessment of the implementation status of the high priority recommendations, totalling 81. All had "action plans" uploaded in CARDS. Of the 81 recommendations, 58 (72 percent) had been implemented, 3 (4 percent) in progress, 12 (15 percent) had not been implemented, and 8 (10 percent) were no longer applicable. This marked a significant improvement over FY 2010 for which 75 out of 201 (37 percent) high priority audit recommendations had been implemented.

5. Conclusion

There was no improvement in financial management, as the NFI of qualified opinions increased from $0.6 million (or 12 percent) in FY 2010 and $0.4 million (or 4 percent) in FY 2011 to $3 million (or 22 percent) in FY 2012 (see Figure 4). One country (Chad) accounted for $2.1 million out of the total $3 million NFI for FY 2012.

Figure 4: Comparison of Net Financial Impact of Modified Opinions ($ million) from 2010 to 2012



As Principal Recipient of Global Fund grants, UNDP is more often than not partnering with SRs whose financial management capacities are sub-optimal, and are operating within difficult country contexts. Recognizing the need for closer monitoring and oversight of SR financial management, the Terms of Reference for the non-governmental organization/national implementation modality audits had been strengthened for financial management and expanded to also include review of internal controls and processes.

To strengthen SR management, the Bureau for Development Policy Global Fund Partnership Team was developing an on-line application to map SRs and Sub-sub-recipients so that Country Offices can have an accurate picture of grant implementation arrangements, flow of funds, and inventory of health products. The development and dissemination of best-practice tools for each stage of the grant life cycle, including a financial management training package would be finalized and included in the UNDP Capacity Development Toolkit. Finally, those SRs identified through the FYs 2012 and 2013 audit process as having sub-optimal management capacities would be targeted for dedicated capacity building activities.

Annex 1: Distribution of audit opinions on the fiscal year 2012 non-governmental organization/national implementation modality audit reports of the Global Fund Sub-recipients

Country Office	Audited Expenses	Total CDR	Adverse		Qualified		Unqualified		NFI Current Year
			# Awards	Amount Audited	# Awards	Amount Audited	# Awards	Amount Audited	
Belarus, Republic of	$716,083	$3,500,995	0	$0	0	$0	1	$716,083	$0
Bolivia	$1,228,884	$1,228,884	0	$0	1	$1,228,884	0	$0	($110,566)
Bosnia and Herzegovina	$5,258,006	$12,770,529	0	$0	0	$0	1	$5,258,006	$0
Chad	$2,077,340	$22,038,732	1	$2,077,340	0	$0	0	$0	($2,077,340)
Congo (Dem. Republic of)	$2,772,009	$23,943,414	0	$0	0	$0	3	$2,772,009	$0
Cuba	$6,580,982	$8,671,731	0	$0	0	$0	3	$6,580,982	$0
El Salvador	$233,288	$4,860,874	0	$0	0	$0	1	$233,288	
Haiti	$8,709,428	$17,225,782	0	$0	2	$8,709,428	0	$0	($248,050)
Iran, Islamic Republic of	$2,256,373	$12,852,419	0	$0	0	$0	1	$2,256,373	$0
Kyrgyzstan	$1,615,983	$5,237,330	0	$0	1	$1,615,983	0	$0	($552,975)
Montenegro	$770,313	$1,237,349	0	$0	0	$0	1	$770,313	$0
Niger	$42,782	$132,562	0	$0	0	$0	1	$42,782	
South Sudan	$804,596	$2,893,726	0	$0	0	$0	1	$804,596	
Tajikistan	$2,287,386	$23,808,073	0	$0	0	$0	3	$2,287,386	$0
Togo	$233,873	$1,023,215	0	$0	0	$0	1	$233,873	
Uzbekistan	$646,081	$7,848,799	0	$0	0	$0	1	$646,081	$0
Zambia	$2,067,787	$29,594,501	0	$0	0	$0	3	$2,067,787	$0
Zimbabwe	$33,333,669	$73,400,239	0	$0	0	$0	5	$33,333,669	$0
Total	**$71,634,863**	**$252,269,154**	**1**	**$2,077,340**	**4**	**$11,554,295**	**26**	**$58,003,228**	**($2,988,931)**

Annex 2: Definition of External Audit Opinions

Unqualified (Clean or positive) Opinion

An *unqualified 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.

Qualified Opinion – a modified (negative) audit opinion

A *qualified opinion* should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. A qualified opinion should be expressed as being 'except for' the effects of the matter to which the qualification relates.

Disclaimer of opinion – a modified (negative) audit opinion

A *disclaimer of opinion* should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

Adverse – a modified (negative) audit opinion

An *adverse opinion* is expressed by an auditor when the financial statements are significantly misrepresented, misstated, and do not accurately reflect the expenses incurred and reported in the financial statements (**UNDP CDR**, statement of cash, statement of assets and equipment).

An adverse opinion is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.