

**UNITED NATIONS DEVELOPMENT PROGRAMME**  
**Office of Audit and Investigations**



*Empowered lives.  
Resilient nations.*

**AUDIT**  
  
**OF**  
  
**UNDP COUNTRY OFFICE**  
  
**IN**  
  
**CHINA**

**Report No. 1605**  
**Issue Date: 15 April 2016**

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## Report on the Audit of UNDP China Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of UNDP China (the Office) from 29 February to 10 March 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, 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 29 February 2016. The Office recorded programme and management expenditures of approximately \$55 million. The last audit of the Office was conducted by OAI in 2012.

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 weaknesses noted in the handling of funds transferred to projects, specifically in incorrectly recording advances as expenses, and performance-based agreement funds remaining idle.

### Good practice

The Office had established a Due Diligence Committee in June 2014 to particularly review and approve the selection of private sector partners for the engagement of development projects. The Committee was following the Policy on Due Diligence and Partnerships with the Private Sector and was using a uniform risk assessment tool for all cases, which enabled the better selection of partners to work with.

**Key recommendations:** Total = 8, high priority = 1

The eight recommendations aim to ensure the following:

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

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. The high (critical) priority recommendation is presented below:

Weaknesses in handling funds transferred to projects (Issue 8)

The review of the Office's financial transactions during the audit period indicated weaknesses, such as incorrectly recording advances amounting to \$0.6 million as project expenses, thus resulting in overstatement of the total project expenditure. The audit also disclosed that the Office had made payments to implementing partners amounting to \$1.5 million that were incorrectly recorded as grant payments, when in fact they were contractual payments made to vendors. In addition, all of the above-mentioned payments were recorded as grants, when in fact they were advances made to the implementing partner, who subsequently disbursed some of the funds as contractual payments to vendors during the audit period. Further, funds for Montreal Protocol funded projects were being disbursed to the implementing partner based on performance. From 2012 to 2015, a total of \$52 million was disbursed to the partner, out of which \$33.5 million still remained with the partner. There was a risk of loss of income generated from interest, related to these funds being idle for a long period of time.

Recommendation: The Office should enhance controls over handling funds transferred to projects by: (a) using the correct account code when recording payments made so that advances are not recorded as expenses, as well as recording project contractual payments as such and not as grant payments; and (b) considering revising the payment schedule that provides direct payment to the recipient at the request of the implementing partner, or transferring funds in smaller tranches based on specific milestones, so that large amounts of funds do not remain unused with the implementing partner for a long period of time.

## Management comments and action plan

The Resident Representative accepted all of the 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. Osttveiten  
Director  
Office of Audit and Investigations

## I. About the Office

The Office, located in Beijing, China (the Country) comprised 52 personnel at the time of the audit fieldwork. The Office entered into a new programming cycle initiated in 2016, and in line with this, it had developed a new Country Programme Document from 2016 to 2020. The new Country Programme Document focuses on key emerging issues that will impact the Country's sustainable development in its economic, social, and environmental aspects. In light of the Country's development experience and global significance, the Document is expected to contribute to poverty eradication and inequality reduction in the Country and in the world through providing support to domestic development and South-South Cooperation.

## II. Good practice

OAI identified a good practice, as follows:

The Office had established a Due Diligence Committee to deliberate on private sector partnerships that the Office planned to enter. The Due Diligence Committee had followed the Policy on Due Diligence and Partnerships with the Private Sector and used a uniform risk assessment tool for all cases, which enabled the better selection of partners to work with.

## III. Audit results

Satisfactory performance was noted in the following areas:

- (a) Human resources management. Adequate controls were established.
- (b) Procurement. The audit indicated that adequate and effective controls had been established.
- (c) General administration. The controls were generally functioning adequately.
- (d) Safety and security. There were no reportable issues regarding the security plan, security risk assessment, and the updated United Nations staff list.
- (e) Information and communication technology. The review of software and hardware management, of site visits conducted to the Office's servers, and of the latest available Disaster Recovery Plan did not identify any reportable issues.

OAI made one recommendation 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:

- (a) Enhance controls over handling funds transferred to projects (Recommendation 8).

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

- (a) Liaise with the Regional Bureau for Asia and the Pacific and the Management Consulting Team to review the existing programmatic partnership arrangement with the Government (Recommendation 1).

- (b) Enhance project assurance and monitoring activities and be guided by the quality assurance system rolled out in March 2016 (Recommendation 5).
- (c) Liaise with the Legal Office to seek advice on the current terms of reference indicated in the present agreement signed with the participating Governments (Recommendation 6).
- (d) Consult with the Regional Bureau for Asia and the Pacific on HACT implementation (Recommendation 3).
- (e) The Resident Coordinator Office should conduct regular annual reviews of the UNDAF and evaluations (Recommendation 4).
- (f) Ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on funds advanced by UNDP (Recommendation 7).
- (g) Liaise with the Office of Financial Resources Management to confirm whether they can retain the funds in the Office as part of their extrabudgetary funds (Recommendation 2).

The detailed assessment is presented below, per audit area:

## A. Governance and strategic management

### 1. Leadership, ethics and values

#### **Issue 1**      Need to review complex implementation arrangements in view of the repositioning of the Office in the Country

According to the Country Programme Document 2016 - 2020, the Country had undergone unprecedented changes over the past 30 years and had achieved remarkable national development progress domestically, and had become a major player in international cooperation. Hence, UNDP's strategy, set-up and operations in the Country needed to keep pace with these changes. The Office had multiple reviews and ongoing discussions at various levels within the Regional Bureau for Asia and the Pacific, Headquarters units, as well as the Government to discuss the long-term strategic positioning of the Office in this evolving context. A Management Consulting Team mission was also scheduled to take place in the second quarter of 2016, to review and make suggestions on the way forward.

Based on the 'UNDP Programme and Operations Policies and Procedures', the Country Programme Action Plan constitutes the legal agreement between UNDP and the Government for implementing the Country Programme. In the absence of a Country Programme Action Plan, project documents should be signed by the respective government coordinating authority, the implementing partner, and the respective UNDP Country Office.

The Office's programme portfolio was being implemented by three main government partners. For all government cost-sharing funded projects, programme coordination and programme implementation was handled by a quasi-governmental body under the supervision of one ministry. Meanwhile, the Global Environment Facility funded projects and the Montreal Protocol funded projects were implemented by two other ministries. Further to this arrangement, the quasi-governmental body acted in a dual role, both as a coordinator as well as an implementing partner. The operational set-up of the implementing partner was similar to a UNDP Country Office when providing development support services to projects. Furthermore, as outlined above, there was no signed Country Programme Action Plan. However, the Office had signed project documents directly with the implementing partners, without the Government's signature. Office management indicated that the relevant ministry had delegated the responsibility of signing project documents to the quasi-

governmental body. However, this arrangement might give rise to a potential conflict of interest. The previous OAI audit (Report No. 969, Issue 4) also referred to these partnership arrangements, and to the potential conflict of interest.

The Office's management informed the audit team that the quasi-governmental body preferred to sign off on one-year instead of two-year work plans due to their budgeting and work planning being conducted on an annual basis. This contributed to some delays and to an uneven rate of programme delivery, with most project activities taking place towards the end of the calendar year. Further, there were also challenges in recovering the Office's direct support costs for the implementation of projects, as the partner was of the view that costs were high. Office management also commented that for historical reasons, it has been difficult to implement projects and not involve the quasi-governmental body, which acted as the designated implementing partner in the Country. This also constrained the Office's ability to broaden its partnership base and limited its resource mobilization potential.

The audit disclosed that while all United Nations agencies in the Country dealt directly with the technical ministries, UNDP and UNIDO had this unique arrangement of working directly with the quasi-governmental body.

As the Office, together with the stakeholders concerned, is considering the future direction and repositioning of UNDP in the Country, key challenges faced by the Office should be reviewed to enhance the Office's overall programme execution and contribution to effective results-based programme management in the Country. If this review is not undertaken, the programmatic partnership arrangement described above may result in the less than optimal contribution of the Office to the Country.

<b>Priority</b>	Medium (Important)
<b>Recommendation 1:</b>	
The Office should liaise with the Regional Bureau for Asia and the Pacific and the Management Consulting Team to review the existing programmatic partnership arrangement with the Government, so that moving forward, a more conducive and coherent arrangement can be established with the Government to better deliver UNDP's mandate in the Country.	
<b>Management action plan:</b>	
With support from the Regional Bureau for Asia and the Pacific and the Management Consulting Team, the Office will engage and consult with the proper authority to work on the issue.	
<b>Estimated completion date:</b> February 2017	

## 2. Financial sustainability

### **Issue 2**      Government Contributions to Local Office Costs not recorded under accounts receivable

The UNDP Standard Basic Assistance Agreement provides that host Governments should contribute towards the cost of Country Offices annually. Further, the 'UNDP Programme and Operations Policies and Procedures' state that the Treasury Contribution Unit or the Office should record the funds received from the Government under accounts receivable.



The Office received \$1.4 million as Government Contributions to Local Office Costs (GLOC) payments for 2014 and 2015. The audit noted that the Office had retained the GLOC payments received in 2014 and 2015 and included them in their extrabudgetary fund instead of recording them under accounts receivable.

The Office's management informed the audit team that this practice had been followed in agreement with the Regional Bureau for Asia and the Pacific following an email communication with the Office of Financial Resources Management in 2013. In OAI's view, however, this email seemed to be related to a different matter (i.e., how to account for funds received for rental of the Office's premises).

Failure to apply GLOC payments to UNDP's records may result in the Office of Financial Resources Management withdrawing funds from the Country's Voluntary Contributions, which may lead to reputational risks for the Office.

<b>Priority</b>	Medium (Important)
<b>Recommendation 2:</b>	
The Office should liaise with the Office of Financial Resources Management to confirm whether they can retain the funds in the Office as part of their extrabudgetary funds or whether they have to record the GLOC payments received for 2014 and 2015 under accounts receivable.	
<b>Management action plan:</b>	
The Office agrees to seek support from the Regional Bureau for Asia and the Pacific and Office of Financial Resources Management on the application of GLOC payments for the Country.	
<b>Estimated completion date:</b> December 2016	

## B. United Nations system coordination

### 1. Harmonized Approach to Cash Transfers

#### **Issue 3** Harmonized Approach to Cash Transfers not fully implemented

To lessen the burden that the multiplicity of United Nations procedures and rules creates for its partners, the Framework for Harmonized Approach to Cash Transfers to Implementing Partners (HACT Framework) requires that participating United Nations agencies (UNDP, UNICEF and UNFPA) agree upon and coordinate 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 Harmonized Approach to Cash Transfers; and (d) development and implementation of an assurance and audit plan for implementing partners.

In the previous audit report, an audit issue was raised on the non-implementation of HACT. The audit recommendation addressing this issue was withdrawn after the Office commented that "little value of scale can be expected from HACT." Upon further requests by Headquarters requiring compliance, the Office decided to implement HACT together with UNICEF and UNFPA in 2015 and had made progress. The Office commented that

an inter-agency HACT working group was established in 2015 to this respect, and two meetings were held. The macro-assessment report was completed in December 2015, which identified some risks related to the public financial management system. HACT training for concerned agencies was conducted in December 2015. An inter-agency HACT meeting had also been scheduled for March 2016 to discuss the findings of the macro-assessment report and decide on the way forward in completing the HACT process. The Government's response to the Office's communications regarding the micro-assessments of implementing partners was still pending at the time of the audit fieldwork.

If the Office together with the HACT working group does not lead the process, there is a risk that HACT implementation may be further delayed.

<b>Priority</b>	Medium (Important)
<b>Recommendation 3:</b>	
The Office should consult with the Regional Bureau for Asia and the Pacific on HACT implementation given the challenging operating context in the Country.	
<b>Management action plan:</b>	
The Office through the Operations Management Team will discuss the findings of the macro-assessment report in early 2016 to discuss a way forward given the constraints and operating context described above. Following this, the Country Office will consult with the Regional Bureau for Asia and the Pacific on the challenges of HACT implementation given the limited value that can be expected from the HACT exercise.	
<b>Estimated completion date:</b> December 2016	

## 2. Development activities

### Issue 4 United Nations Development Assistance Framework evaluation not undertaken

The 'UNDP Programme and Operations Policies and Procedures' require an annual review of the United Nations Development Assistance Framework (UNDAF), as this is an integral part of United Nations system monitoring at the country level. Further, it enables offices to assess the achievement of overall annual targets of UNDP funded activities in the context of UNDAF and national outcomes.

The UNDAF 2011-2015 stated that several types of monitoring and evaluations would be undertaken during the programme cycle. It indicated that "a mid-term review of the UNDAF will be conducted in 2012/13 to coincide with individual agency programme mid-term reviews. An end of cycle evaluation will assess achievements, lessons learned and best practices, so as to build solid foundation for the next UNDAF." However, neither the mid-term nor the end of cycle evaluations were undertaken. Hence, the United Nations agencies were not able to leverage on benefits that may have been derived from these reviews and evaluations. Further, the UNDAF progress reviews were not conducted annually.

In preparation for the new UNDAF, the Resident Coordinator Office commented that given the Country's fast changing context and needs, and the evolving nature of United Nations programmes, concerted efforts were put into a repositioning exercise of the United Nations Country Team in the Country and on a dialogue with the

Government to better understand the expectations from the United Nations in the Country in the post-2015 context. It further added that this exercise, from 2012 to 2014, resulted in a paper outlining recommendations on the most effective ways for the United Nations to engage in the changing context in the Country, which provided substantive inputs into the development of the new UNDAF that was articulated at a strategic level to fit the context in the Country.

While the audit team acknowledged the United Nations Country Team's overall efforts, the failure to undertake UNDAF evaluations may prevent the Resident Coordinator Office from obtaining valuable information on the progress made and on lessons learned from past experiences, which would be beneficial in implementing programmes in the future. Further, there was no evidence that the United Nations Country Team had informed the UN Development Operations Coordination Office or the Regional Bureau for Asia and the Pacific that evaluations were not necessary in the context of discussions with the Government.

<b>Priority</b>	Medium (Important)
<b>Recommendation 4:</b>	
The Resident Coordinator Office should conduct regular annual reviews of the UNDAF and evaluations. If the evaluations are not to be undertaken, the Resident Coordinator Office should consult with the UN Development Operations Coordination Office or the Regional Bureau for Asia and the Pacific.	
<b>Management action plan:</b>	
The Resident Coordinator Office will ensure that that annual reviews are conducted according to the terms stipulated in the new UNDAF 2016-2020. With inputs provided by the respective United Nations Country Team theme and subgroups, the annual review processes will contribute to the evaluation that is scheduled for the end of the UNDAF cycle.	
<b>Estimated completion date:</b> December 2016	

## C. Programme activities

### 1. Project management

#### Issue 5 Inadequate project assurance management

The following weaknesses were noted related to project assurance activities:

##### (a) Inadequate project field visits

The 'UNDP Programme and Operations Policies and Procedures' stipulate that as part of the assurance function, a representative from the UNDP office should visit each project at least once a year. Field visits serve the purpose of results validation and should provide the latest information on progress for annual reporting preparation. Apart from visits from the programme staff in offices, project personnel should also undertake regular field visits to assess and track project progress while addressing any project implementation issues in a timely and effective manner.

Based on a sample review of 20 projects, the Office's programme personnel had conducted project site visits to 4 projects during the audit period. The number of project site visits conducted by the Office's personnel was significantly low. This raised the risk of inadequate project monitoring. Although the Office had other monitoring activities in place for most projects, field visits are still an important monitoring tool, particularly in an environment where more than 90 percent of projects are nationally implemented. In the absence of sufficient documentation of the issues faced by projects, the Office may face challenges in monitoring projects and in taking appropriate action, especially when there are changes in programme personnel in the Office.

Further, the review of the back-to-office reports of the four project site visits indicated that in two cases, they were not related to project field visits to monitor project progress, as these visits related to Office staff conducting trainings, workshops and interviews for implementing partners.

Failure to conduct regular and adequate project field visits may prevent the Office from tracking the progress of projects and take appropriate actions whenever required.

(b) Failure to update risk and issue logs for development projects

The 'UNDP Programme and Operations Policies and Procedures' require risk logs, issue logs and lessons learned logs to be created in Atlas (enterprise resource planning system of UNDP) and updated regularly. A sample review of 10 projects indicated that the risk logs, issue logs and lessons learned logs were not updated regularly. The Office acknowledged that the risk log tool in Atlas had not been frequently updated; however, the Office indicated that risks are recorded and discussed as per the project risks and issues part of the standard annual and quarterly project progress reports, under the "risk management" section.

Further, the Office's management commented that in 2015 it had piloted a quality assurance system, which included a section on project risks and issues and where 20 projects self-reported risks and issues. However, the sample review of project progress reports indicated that annual and quarterly project progress reports did not adequately describe the risks and issues faced by development projects. Furthermore, the project progress reports did not state the actions to be taken to manage these risks and issues, as it was meant to be a reporting tool and not a risk management tool.

Failure to update risk and issue logs in a timely manner may prevent the Office from monitoring and taking adequate actions to address project risks.

The Office's management commented that its project monitoring improved over the years and it established a monitoring and evaluation team in 2014 to coordinate all the monitoring and evaluation functions. This included developing and implementing a series of tools (such as the China Monitoring and Evaluation Manual, templates, and other intranet based online tools) as well as internal quality check procedures and regulations with clear timelines. Management further indicated that, if seen as isolated cases, some of the above-mentioned shortcomings may seem to suggest weak project assurance. However, the Office had established various compensating controls, such as having several programme personnel aware of key issues affecting projects in general, using electronic social tools to communicate with implementing partners, and having project personnel resolve any project related issues where needed.

(c) Weaknesses in project progress reports

The 'UNDP Programme and Operations Policies and Procedures' indicate that the regular review of project progress reports is a means of exercising effective programme assurance for programme personnel. Furthermore, based on an agreed upon regular reporting and review schedule (minimum annually, but recommended quarterly) the Project Manager should submit a report to the Project Board. The project progress reports should provide an analysis of project performance over the reporting period.

There were weaknesses in project progress reports submitted to stakeholders. From a sample of 10 projects reviewed, the progress reports were generally activity-based and did not necessarily report at the output and outcome levels. As such, the reader may not have been able to assess the progress made towards achieving project outputs and outcomes.

The Office's management indicated that they updated and implemented a good quality check system to enhance the process. Management attributed some of the weaknesses in quality to varied project management office staff backgrounds, which provided for different styles of reporting. Besides this, the Office's management indicated that office-wide and project-based workshops on project management, reporting, and results-based management were organized for project management office personnel.

Although the audit team acknowledged the efforts taken by the Office in recent years, the above weaknesses relating to inadequate project management and assurance need to be resolved, otherwise these may prevent projects from meeting their intended objectives and outputs.

Priority	Medium (Important)
<b>Recommendation 5:</b>  The Office should enhance its project assurance and monitoring activities and be guided by the quality assurance system rolled out in March 2016, at a minimum by: <ul style="list-style-type: none"> <li>(a) conducting regular project site visits, especially to projects that are assessed to be high risk; and</li> <li>(b) enhancing the quality of progress reports to ensure they include progress made towards achieving project targets, outputs and objectives.</li> </ul>	
<b>Management action plan:</b>  The Office will enhance project assurance through the following: <ul style="list-style-type: none"> <li>(a) frequently performing field visits reviews; and</li> <li>(b) renewing risk and issue logs and training implementing partners and project management offices to ensure quality of project reports, following the new quality assurance system in place. In addition, the Office will strengthen the risk reporting in reports by including the reporting indicator to make them more progress/output/outcome orientated, and improving the quality of back-to-office reports to ensure that they reflect on project progress, with some key issues/achievements to be addressed.</li> </ul>	
<b>Estimated completion date:</b> September 2016	

**Issue 6**      Project's signed agreement not fully complied with

The Office manages the Greater Tumen Initiative Trust Fund, which is funded through contributions by four participating Governments. The funds are used to implement the Greater Tumen Initiative Project, which had project expenditure of \$0.9 million for 2015. As per the agreement signed with the participating Governments in May 2006, the administration of the Greater Tumen Initiative Trust Fund should be subject to UNDP's Financial Regulations and Rules and should be in conformity with UNDP procurement rules and procedures. Further, the agreement states that the Greater Tumen Initiative Trust Fund shall be subject to internal and external audit procedures of the United Nations, while UNDP shall provide the Project's Consultative Commission with audited annual statements of accounts.

The Office had not provided the Project's Consultative Commission with audited annual statements of accounts since the agreement was signed in 2006. Furthermore, during the audit period, procurement transactions were undertaken by the Project's secretariat office, which had been formed to undertake much of the operational tasks that were being initially handled by the Office. There was no assurance that the transactions undertaken by the project's secretariat office were in compliance with UNDP's rules and regulations.

Office management indicated that no audited statements were requested by the participating Governments in the past years. The Project's Consultative Commission was only reviewing the project budget and expenditures incurred in accordance with annual work plans.

By not fully complying with the Greater Tumen Initiative Trust Fund agreement signed with participating Governments, UNDP may be exposed to legal risks.

<b>Priority</b>	Medium (Important)
<b>Recommendation 6:</b>	
The Office should liaise with the Legal Office to seek advice on the current terms of reference indicated in the present agreement signed with the participating Governments, so that if required, an amendment can be made upon consultation with them to better reflect the actual work and functions presently carried out by UNDP.	
<b>Management action plan:</b>	
The Office will prepare the amendment to the agreement and consult with the Legal Office accordingly.	
<b>Estimated completion date:</b> June 2016	

**Issue 7**      Bank statements not submitted with Funding Authorization and Certification of Expenditures forms

The 'UNDP Programme and Operations Policies and Procedures' require that in order to receive funds advanced by UNDP, the implementing partner for a project should open a bank account to be used only for receiving UNDP advances and to make payments for the project. The UNDP office should receive a copy of the account signatories. Bank statements must be filed by the project and a copy must be submitted to the UNDP office with the Funding Authorization and Certification of Expenditures (FACE) forms. Alternatively, the implementing



partner may use an existing bank account under the implementing partner's name, but this option may only be followed with the agreement of UNDP's Programme Officer, and the approval of the Deputy Country Director/Operations or the head of the Finance Unit. In making this decision, the office should consider the inherent risks involved, using the assurance mechanisms described in the HACT Framework, particularly on conducting micro-assessments.

Out of a total \$35 million in advances granted to national implementing partners and \$29 million in liquidations related to those advances, the audit reviewed 40 sample FACE forms amounting to \$3.3 million in advances and \$2.7 million in liquidations and noted that bank statements were not submitted to the Office. Without bank statements, there is a risk that cash transferred to implementing partners may not be used for intended purposes and may not be in accordance with the agreements between UNDP and the implementing partners.

Office management commented that bank statements were not attached along with FACE forms because implementing partners did not maintain dedicated bank accounts for UNDP projects. As compensating controls to mitigate risks of not maintaining dedicated bank accounts for projects, both the Office and the implementing partner sign off on project combined delivery reports at the end of each financial year. In addition to this, project audits are undertaken in accordance with the UNDP procedures. Office management informed the audit team that they obtained assurance through the signed combined delivery reports, which indicated the balance of advances that still remained with implementing partners. However, the audit team did not consider this an adequate control to mitigate the risk described above because the combined delivery reports do not provide assurance on the existence of cash balances at the implementing partner level, and do not allow the Office to track financial transactions related to projects, which otherwise could be traced in bank statements. Furthermore, the Office did not comply with the respective guidelines regarding the case where the implementing partner used an existing bank account.

Failing to ensure that implementing partners maintain bank accounts dedicated to UNDP projects, or failing to comply with the guidelines regarding the use of existing bank accounts, may result in the risk of funds being used for unintended purposes.

<b>Priority</b>	Medium (Important)
<b>Recommendation 7:</b>	
The Office should ensure compliance with the 'UNDP Programme and Operations Policies and Procedures' on funds advanced by UNDP. This should include the implementing partners opening dedicated bank accounts for UNDP projects and submitting bank statements together with FACE forms. Alternatively, if implementing partners prefer to use existing bank accounts, the Office should implement the assurance mechanisms described in the HACT Framework.	
<b>Management action plan:</b>	
The Office will discuss with the implementing partners to further explore the possibilities of opening dedicated bank accounts for UNDP projects. If this is not possible, then alternative assurance mechanisms will be put in place and the Office will discuss with implementing partners on the legitimacy of government entities to provide bank statements to other organizations including UNDP.	
<b>Estimated completion date:</b> December 2016	

## D. Operations

### 1. Financial management

#### Issue 8 Weaknesses in handling funds transferred to projects

According to the 'UNDP Programme and Operations Policies and Procedures', UNDP is accountable for the effective and efficient use of resources for the achievement of programme results. As per the International Public Sector Accounting Standards adopted by UNDP beginning January 2012, expenses are recognized when goods (non-capital) or services have been received. The review of the Office's financial transactions during the audit period identified the following weaknesses:

(a) Incorrect recording of advances as expenses

The Office transferred advance payments amounting to \$0.6 million to two national institutions (under two directly implemented projects) to undertake project activities as agreed in project annual work plans using letters of agreement. As these were advances made to national institutions for project activities to be undertaken in the future, the Office should have recorded these payments as project advances instead of immediately recording them as project expenses. The Office's action of recording project advances as expenses resulted in overstating the project expenses. The Office's management commented that they had recorded the advances given to these national institutions as project expenses because these were directly implemented projects, and therefore felt the advance balance account (16005) was not supposed to be used.

(b) Incorrect account code used for payments to implementing partners

Payments to implementing partners amounting to \$1.5 million were incorrectly recorded as grant payments, when in fact they were contractual payments made to vendors. In addition, all of the above-mentioned payments were recorded as grants when in fact they were advances made to the implementing partner, who subsequently disbursed some of the funds as contractual payments to vendors during the audit period.

(c) Funds remaining idle due to structure of performance-based payment agreements

For Montreal Protocol funded projects, the Office agreed on using the performance-based payment method to disburse funds to the implementing partner. Accordingly, the payments were made to the implementing partner in instalments based on project milestones indicated in project payment schedules.

The audit noted that there were weaknesses in the schedule of payment arrangements, as the funds disbursed to the implementing partner remained with them for long periods of time before being disbursed to the actual recipient. For instance, from 2012 to 2015, a total of \$52 million was disbursed to the implementing partner while only \$18.5 million (35 percent) was utilized by September 2015 for the purposes of the Montreal Protocol funded projects. Consequently, as at September 2015, there was \$33.5 million that remained with the national implementing partner.

Similar to item (a) above, the audit review noted that funds disbursed were immediately recorded as expenses, although they were not utilized immediately or only utilized much later. For instance, the Office disbursed \$7.7 million for one project as second and third payments to the implementing partner on 22 and 28 December 2015. The amount was immediately recorded as an expense even though the funds could not have been fully utilized during 2015. When the second payment was processed for this project in December 2015, the implementing



partner indicated that only 53.8 percent of the previous payment (the total first payment amounted to \$3.3 million) had been disbursed, which meant that the remaining 46.2 percent of the first payment was not spent although the Office had indicated this payment as a project expense in its records.

Office management commented that they received clear guidance from Headquarters in 2011 to use the particular account code for the first performance-based payment. Office management indicated that they had been having concerns about the use of this account code (recording the advances as project expenses and communicating several times with Headquarters in the past years).

During its recent audits of Country Offices in the Asia Pacific region, OAI noted that similar types of payments made to implementing partners to Montreal Protocol funded projects had been correctly recorded as advances and FACE forms were used to clear these advances when financial reports were submitted.

The failure to record financial transactions correctly in accordance with the International Public Sector Accounting Standards may result in projects producing misleading financial statements. Large amounts of funds remaining with implementing partners for extended periods of time may result in the risk of funds being used for unintended or unauthorized purposes.

<b>Priority</b>	High (Critical)
<b>Recommendation 8:</b>  The Office should enhance controls over handling funds transferred to projects by: <ul style="list-style-type: none"> <li>(a) using the correct account code when recording payments made so that advances are not recorded as expenses, as well as recording project contractual payments as such and not as grant payments; and</li> <li>(b) considering revising the payment schedule that provides direct payment to the recipient at the request of the implementing partner, or transferring funds in smaller tranches based on specific milestones, so that large amounts of funds do not remain unused with the implementing partner for a long period of time.</li> </ul>	
<b>Management action plan:</b>  The Office plans to do the following: <ul style="list-style-type: none"> <li>(a) For incorrect recording of advances for directly implemented projects, they will communicate with Headquarters to see if it is appropriate to use the national execution advance account for payments under directly implemented projects, and will follow their guidance accordingly for similar payments in the future. In terms of the incorrect account code used, the Office will communicate with implementing partners for the proper use of accounts for contractual payments made to vendors.</li> <li>(b) Regarding performance-based payments, the new guidance issued by the Office of Financial Resources Management has brought clarity to the account code to be used and the Office will be amending the account code going forward.</li> </ul>	
<b>Estimated completion date:</b> December 2016	

## 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.