UNITED NATIONS DEVELOPMENT PROGRAMME
Office of Audit and Investigations

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AUDIT

OF

UNDP COUNTRY OFFICE

IN

PANAMA

Report No. 1691

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Report on the Audit of UNDP Panama

Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of UNDP Panama (the Office) from 6 to 17 June 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 30 April 2016. The Office recorded programme and management expenditures of approximately $36 million. The last audit of the Office was conducted by OAI in 2010.

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 **satisfactory,** which means, "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."

Key recommendations: Total = **6**, high priority = **1**

Objectives	Recommendation No.	Priority Rating
Achievement of the organization's strategic objectives	4	High
	1, 3	Medium
Effectiveness and efficiency of operations	2, 6	Medium
Compliance with legislative mandates, regulations and rules, policies and procedures	5	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 within project management (Issue 4)	There were weaknesses with regard to project management, such as Results and Resources Frameworks and indicators that were not specific, measurable, attainable, relevant, and time bound. There were also inadequate monitoring and assurance activities, such as lack of Project Board meetings, incomplete annual project progress reports, and an outdated Atlas (enterprise resource planning system of UNDP) project module. Recommendation: The Office should strengthen project management by: (a) developing Results and Resources Frameworks with clearly articulated baselines, indicators and targets; (b) ensuring regular Project Board meetings are held, to endorse the Annual Work Plan, and review project progress; (c) requesting the implementing partner to sign the Annual Work Plan and Combined Delivery Reports; (d) preparing consistent, project annual progress reports which include an explanation of significant budget variances, information on risk and challenges and report on the level of achievement of outcome targets as specified within the Annual Work Plan; and (e) regularly updating project monitoring information within Atlas.

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 have 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 Panama City, Panama (the Country) had 21 staff members under fixed-term appointments and 90 service contract holders at the time of the audit. The Office was implementing a Country Programme agreed with the Government for the period 2016-2020. Based on the situational analysis, the programme interventions were focused on the following areas: basic services; citizen participation and democracy; security and justice; and sustainable development.

II. Audit results

Satisfactory performance was noted in the following areas:

(a) Organizational structure and delegations of authority. The Office had adequate controls in place over organizational structure and delegations of authority.

(b) Leadership, ethics and values. The Office's actions following the Global Staff Survey and completion of ethics and legal framework mandatory training were reviewed with no reportable issues.

(c) Development activities. The coordination and preparation of the 2016-2020 United Nations Development Assistance Framework was reviewed, and controls were found to be adequate with no reportable issues.

(d) Resident Coordinator Office. The preparation and completion of the Annual Work Plan, minutes and frequency of United Nations Country Team meetings were reviewed with no reportable issues.

(e) Partnerships and resource mobilization. The Office maintained good relations with the Government, its main counterpart, and had taken action to diversify its funding.

(f) Human resources. Adequate controls were established in human resources management. The review of recruitment, separation, salary payments and management of benefits and entitlements did not identify any reportable issues.

(g) Finance. Payment processing, disbursements and banking activities were found to be compliant with financial policies and procedures

(h) General administration and asset management. Controls over general administration practices, including common services, fuel management, vehicle management and travel management were found to be adequate. Asset management was in line with UNDP policies and procedures.

(i) Safety and security. Safety and security controls were assessed to be adequate and functioning well.

(j) Leave management. Approval and reporting of leave was found to be in compliance with UNDP policies and procedures.

OAI made one recommendation ranked high (critical) and five 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 recommendation:

(a) Strengthen project management by developing Results and Resources Frameworks, ensuring regular Project Board meetings are held, and preparing annual project progress reports (Recommendation 4).

Medium priority recommendations, arranged according to significance:

(a) Pursue full implementation of direct project costs for support services to nationally implemented projects (Recommendation 1).
(b) Strengthen programme management by completing a capacity assessment of each implementing partner and finalizing guidance notes for review (Recommendation 3).
(c) Improve the management of information and telecommunication technology (Recommendation 6).
(d) Ensure that all contracts are awarded following a competitive bidding process (Recommendation 5).
(e) Pursue the full implementation of HACT (Recommendation 2).

The detailed assessment is presented below, per audit area:

A. Governance and strategic management

1. Financial sustainability

Issue 1 Direct project costs of support services to nationally implemented projects not fully recovered

Direct project costs are organizational costs incurred in the implementation of a development activity or service that can be directly traced and attributed to that development activity or service. Therefore, these costs are included in the project budget and charged directly to the project budget for the development activity and/or service. Implementation support activities or services are costs incurred by UNDP and proportionally added to the project, to support project implementation by operations units, including services related to finance, procurement, human resources, administration, issuance of contracts, security, travel, assets, general services and information and communications technology. The degree of such support depends on the implementation arrangements agreed to with the Government, described in the annexes of the Project Document or Country Programme Action Plan, and on an agreement signed between the UNDP office and the designated national partner.

The Office provided support services to nationally implemented projects. However, it had not been charging the costs of these services to nationally implemented projects due to the lack of signed agreements with the Government on the services provided and related costs for old projects. During the audit period, the Office recovered costs for 3 out of the 21 ongoing nationally implemented projects that received support services. Since 2014, six Letters of Agreement for support services had been signed for all new projects under national implementation. However, the Office had yet to sign with the Government Letters of Agreement for 15 nationally implemented projects. The signed Letters of Agreement referred to the cost recovery of services related to procurement, human resources and training. However, the costs of other services provided, such as finance and other administrative costs were not included in the Agreements. The Office explained that the Government considered that these costs were already being charged under the General Management Service costs.

The audit team acknowledged the efforts made by the Office to sign Letters of Agreement with the Government and implement the direct project cost methodology in the cost recovery of support services to nationally implemented projects. However, not fully adhering to the cost-recovery policy may negatively impact the Office’s financial sustainability.

Priority	Medium (Important)
Recommendation 1: The Office should continue pursuing the full implementation of direct project costs for support services to nationally implemented projects by: (a) signing a Letter of Agreement for the provision of support services with all implementing partners of nationally implemented projects, including the corresponding annexes within the Project Document; and (b) recovering costs according to the direct project cost guidelines for all the services provided to nationally implemented projects.	
Management action plan: The Office will continue to show ongoing progress towards achieving the direct project cost targets set up by the Regional Bureau for Latin America and the Caribbean, and will: (a) Sign Letters of Agreement for all new projects under the national implementation modality. The Letters of Agreement will have an annex with the prices where the cost to be recovered for services rendered by UNDP will be clearly spelt out. (b) For old projects implemented under the nationally implementation modality and that have no Letter of Agreement, the Office will continue to negotiate either the closure of old projects and the opening of new ones, or the signing of a Letter of Agreement through the implementation of a substantive revision. **Estimated completion date:** (a) 30 September 2017 (b) 31 December 2017	

B. United Nations system coordination

1. Harmonized Approach to Cash Transfers

Issue 2 Harmonized Approach to Cash Transfers not fully implemented

The Framework for Harmonized Approach to Cash Transfers (HACT) represents a common operational framework for transferring cash to government and non-governmental implementing partners, irrespective of whether these partners work with one or multiple United Nations agencies. Compliance is achieved when the following components have been completed: (a) a macro-assessment of the public financial system; (b) micro-assessments of implementing partners; (c) agreement with the government on implementing HACT; and (d) development and implementation of an assurance and audit plan for implementing partners. The purpose of the macro-assessment is to ensure adequate awareness of the public financial management environment within which agencies provide cash transfers to implementing partners. The macro-assessment is updated during interim periods of the programme cycle if circumstances change significantly or if changes are identified in the

Country's public financial management environment. The purpose of the micro-assessment is to assess the implementing partner's management capacity to determine the overall risk rating and assurance activities. The risk rating is taken into consideration to determine the cash transfer modalities for an implementing partner together with results from the macro-assessment, and past experience with the implementing partner, including timely and accurate reporting on previous cash advances and the Country Office's own capacity.

Although the Office complied with most of the steps necessary for HACT implementation, reaching 92 percent in the HACT readiness dashboard, the audit noted the following:

- The macro-assessment report was issued in January 2016. After the issuance of the report, a national procurement law was substantively revised by the National Assembly. This law included important changes that might have affected the public financial management environment that was initially assessed in the macro-assessment. The Office's management indicated that a United Nations Country Team meeting was going to be held to decide what actions to take regarding the macro-assessment report, which had yet to be shared with other parties. After the audit, some clauses of the law were vetoed by the Government and the law went back to the National Assembly for further revision. The Office informed the audit team that a revision of the macro-assessment would be undertaken after the final approval of the national procurement normative framework.

- The Office had 10 implementing partners of nationally implemented projects: 2 non-governmental organizations and 8 national counterparts. The disbursement modality to the non-governmental organizations was through cash advances, while the disbursement modality adopted for national counterparts was through direct payments. As of the date of the audit, 9 out of 10 of the micro-assessments planned for 2015 and 2016 were conducted and overall risks determined were low risks in all cases, with the exception of one national counterpart that received a moderate risk rating. However, there was no evidence of documentation on the final risk rating and decisions to determine the appropriate cash transfer modality after the micro-assessment results. The Office continued with the same disbursement modality to non-governmental organizations and national counterparts. The Office's management indicated that the decision to maintain the direct payment modality was based on the political context and on recent cases of investigations in the Country. Moreover, the Office was working on strengthening the capacity of implementing partners to lay the ground for an effective transition of modality while minimizing risks.

The objectives of harmonizing practices among the United Nations agencies, including lessening the burden of using multiple procedures, will not be achieved unless HACT is fully implemented.

Priority	Medium (Important)
Recommendation 2: The Office should pursue full implementation of HACT by: (a) revising the macro-assessment if the new procurement law affects the public financial management environment initially assessed; and (b) documenting the decision regarding the selected cash transfer modality following the results of micro-assessment of implementing partners.	
Management action plan:	

(a) The Office will work with the other United Nations Development Group Executive Committee agencies to complete the macro-assessment exercise in due form. In the event the new national procurement law is approved (which is not the case now), a revision of the macro-assessment will be conducted.
(b) For all micro-assessments implemented/to be implemented, the Office will complete the sign-off document indicating the level of risk identified and the cash transfer modality selected.

Estimated completion date:

(a) 30 September 2016
(b) 31 December 2016

C. Programme activities

1. Programme management

Issue 3 Capacity assessment of implementing partners not completed

The following weaknesses regarding strengthening the capacity of the implementing partners were noted:

- Capacity assessments of implementing partners not completed

  The 'UNDP Programme and Operations Policies and Procedures' stipulate that in order for an entity to execute or implement a UNDP project, a capacity assessment should be completed covering the following areas: technical, managerial, administrative and financial capacity. Through the assessment, the office should determine additional measures to ensure that the project results are achieved. These should be documented and followed up through an action plan. Following the assessment, the office determines the appropriate cash transfer modality for project finances.

  The Office had 21 nationally implemented projects, out of which 5 were sampled, with a combined expenditure of $5.7 million. For four out of the five nationally implemented projects sampled, the Office had not completed a capacity assessment of the four corresponding implementing partners or documented the cash transfer modality selected. The Office had been implementing two projects through two of these partners for between 8 and 10 years, respectively.

  The Office's management explained that while a full capacity assessment had not been completed, a micro-assessment covering the financial component for four of the implementing partners sampled was completed in 2015. However, this had not led to the development of a capacity-building plan, or a conclusion regarding the most appropriate cash transfer modality (refer to issue 2 - Harmonized Approach to Cash Transfers not fully implemented and the corresponding recommendation 2b)

- UNDP's role within project design not elaborated

  The 'UNDP Programme and Operations Policies and Procedures' require the project strategy to articulate how UNDP will support policy development and strengthen national capacities and partnerships to ensure sustainability.

  The audit sample included three projects which were established in 2005, 2008 and 2012, for which the contribution of UNDP in strengthening the national capacity had not been included within the project design. Improvements had been noted for newer projects, such as one project signed in May 2015. The Office's management acknowledged that the role of UNDP in the older projects had mostly been administrative. They confirmed that for the older projects, the Office would either complete a substantive project revision or close the project. The Office's management informed OAI that they were preparing guidance notes to be used during project design to ensure that the contribution of UNDP in building national capacity is documented.

In the event a capacity assessment is not completed and the role of UNDP in strengthening the capacity is not included within the project design, long-term programme results may not be achieved.

Priority	Medium (Important)
Recommendation 3: The Office should strengthen programme management by: (a) undertaking a capacity assessment of each implementing partner when required; and (b) finalizing the guidance notes for project review and ensuring that the strategy section of each project elaborates how UNDP will support the strengthening of national capacities. For existing projects, the Office should either make substantive revisions or close the project at the earliest opportunity.	
Management action plan: (a) The Office will complete the capacity assessment of all implementing partners for each new project being signed. The Office will seek ways to ensure that this exercise is undertaken in coordination with the micro-assessments to be carried out for the Harmonized Approach to Cash Transfers. (b) A guidance note for project review, detailing all corporate requirements established for quality assurance, will be produced, including a checklist to be used at the pre-Project Appraisal Committee level. **Estimated completion date:** (a) Continuing/ongoing (b) 31 December 2016	

2. Project management

Issue 4 Weaknesses within project management

The following weaknesses within project management were noted:

- Lack of comprehensive Results and Resources Framework

The 'UNDP Programme and Operations Policies and Procedures' require projects to develop a comprehensive Result and Resources Framework, identify the outputs, indicators, baselines, indicative activities and a budget for each of the activities being implemented.

There were weaknesses in the project Results and Resources Frameworks, including indicators that were not specific, measurable, attainable, relevant, and time bound. For example, in one case, the project included the indicator ''percentage execution of the output is a function of improving health of the country; baseline 0 percent goal 100 percent." Two other projects had been extended several years beyond the original time frame to accommodate new activities, and the corresponding Results and Resources Framework had not been revised to include annual output targets and new activities. The Office's management acknowledged the weaknesses identified and confirmed that for the older projects, improvements were required to strengthen the Results and Resources Framework, which would be achieved through substantive project revisions.

Without properly defined Results and Resources Frameworks, the Office will not be able to assess the progress of the respective projects, account for resources spent on activities, or measure the project's impact.

- Inadequate monitoring and assurance activities

The 'UNDP Programme and Operations Policies and Procedures' state that Project Boards should provide overall guidance and direction to projects, review project progress, and address project issues. Once a Project Document is signed, the Office must ensure adequate monitoring by preparing annual project reports, and maintaining issue, monitoring and risk logs.

The following exceptions were identified in relation to project monitoring and assurance activities:

- There were no Project Board meetings held for four out of seven projects sampled within the 16-month audit period. This meant there was no endorsement of the Annual Work Plans for 2015 and 2016, or review of project progress by the Project Board. The Office's management explained there had been challenges in facilitating Project Board meetings due to changes in government officials and the difficulty in being able to schedule convenient times for all participants.

- The Annual Work Plans and Combined Delivery Reports for 2015 were not signed by the implementing partner for two projects, and in the case of another project, the Combined Delivery Report had not been signed by the implementing partner.

- Annual project progress reports were incomplete. For example, no explanation was provided for significant budget variances in two cases, information on risks and challenges were not included for two projects, and in one case, the progress on achievement of output targets was not documented. Furthermore, for two projects, output targets reported were not consistent with the indicators included within the Annual Work Plan and Project Document.

- The Atlas project module was not regularly updated. For example, in the case of one project, there were no updates since 2011, in another case there were no updates in the period 2009-2016, and for another project the risk log was last updated in January 2013. The Office's management explained that with the recent recruitment of the Monitoring and Evaluation Analyst, there was now a dedicated resource in place to improve the quality of annual progress reports and ensure monitoring information was regularly updated.

The lack of effective monitoring could prevent the Office from determining whether intended results are being achieved, and/or whether corrective actions are required for timely actions.

Priority High (Critical)
Recommendation 4: The Office should strengthen project management by: (a) developing Results and Resources Frameworks with clearly articulated baselines, indicators and targets; (b) ensuring regular Project Board meetings are held, to endorse the Annual Work Plan, and review project progress; (c) requesting the implementing partner to sign the Annual Work Plan and Combined Delivery Reports; (d) preparing consistent annual project progress reports which include an explanation of significant budget variances, information on risks and challenges, and report on the level of achievement of outcome targets as specified within the Annual Work Plan; and (e) regularly updating project monitoring information within Atlas.
Management action plan: (a) For older projects, the Office will continue to negotiate either the implementation of a substantive revision where a new resources framework can be included, or the substitution of the old project for a new one. (b) All projects will hold Project Board meetings at least once a year, as prescribed in the Office Monitoring & Evaluation Plan being developed. (c) The Office will issue a memo clarifying that Annual Work Plans and Combined Delivery Reports must be signed by the implementing partner. (d) Annual progress reports will be produced for all projects under the Office's portfolio and the Office Monitoring & Evaluation Plan being developed will articulate the roles and responsibilities. (e) All projects will be updated regularly in Atlas in line with the Office Monitoring & Evaluation Plan being developed. This will identify persons responsible and the frequency with which updates are required **Estimated completion date:** (a) 31 September 2017 (b) 31 December 2016

(c) Already being implemented
(d) 31 December 2016
(e) 31 December 2016

D. Operations

1. Procurement

Issue 5 Inadequate justification for direct contracting

The 'UNDP Programme and Operations Policies and Procedures' stipulate that all procurement processes need to be conducted in a fair and transparent manner, and in the interest of obtaining best value for money, which is gained through a competitive tender process.

During the period under review, the Office conducted 656 procurement processes for a total amount of $15.8 million. Out of these 656 processes, 18 processes totalling approximately $321,000 were conducted through direct contracting. A further review of 12 of these processes showed that in 8 cases the justification was listed as "The proposed contract is for relevant services that cannot be objectively evaluated" without any further justification as to why the requested services could not be objectively evaluated. The audit noted that for two of the cases reviewed the reason for direct contracting had nothing to do with the complexity or uniqueness of the work to be done, but was rather based on time constraints (work needed to start immediately, and there was no time for a proper procurement process). In another case, the reason for direct contracting was based on a request from the Government and not on the fact that the work to be contracted was of such a unique or complex nature that it could not be procured competitively.

Procuring through direct contracting without appropriate justification increases the risks of non-transparent procurement and of not receiving best value for money.

Priority Medium (Important)

Recommendation 5:

The Office should ensure that all contracts are awarded following a competitive process and that the use of direct contracting procurement is limited to exceptional circumstances.

Management action plan:

The Office will improve its planning processes through the formulation of improved procurement plans to limit direct contracting to the provisions considered in the 'UNDP Programme and Operations Policies and Procedures'.

Estimated completion date: December 2016

2. Information and telecommunication technology

Issue 6 Weaknesses in information and telecommunication technology management

Information systems operated by UNDP are critical assets for the organization to fulfil its mission. There are always threats, both natural and human in nature, which can damage or disable critical information systems. Therefore, adequate planning, management, data back-up, equipment replacement, software updates, and disaster recovery planning becomes fundamental for the Country Office.

The following weaknesses were noted regarding the Office's information technology and management:

- The Office used Windows Server 2003 and Windows Server 2008 as operating systems for its servers. Windows Server 2003 was no longer supported by Microsoft and the end date of support for Windows 2008 was approaching. Using software that is no longer (fully) supported exposes the Office to an elevated risk to cybersecurity dangers, such as malicious attacks or electronic data loss since software that is not supported will no longer receive the following: (i) security patches that would help protect against harmful viruses, spyware, and other malicious software; or (ii) technical support from Microsoft.

- For data back-up, the Office used a system with tape back-up cartridges. The size of the cartridges was relatively low (400 GB and 800 GB when data is compressed), with the effect that back-ups could not be scheduled to take place automatically since the tapes had to be manually changed. Having to manage data back-ups manually increases the risk of an inadequate back-up procedures.

- The Disaster Recovery Plan of the Office had not been tested. By not properly testing the Plan, the Office will not know whether the Plan will work or not and will therefore not have the assurance that it can adequately and timely recover its information and telecommunication technology systems after an emergency.

Without adequate management of information and telecommunication technology, the Office is exposed to possible interruptions of services and data loss, which may affect the ability to use corporate systems and resources.

Priority Medium (Important)
Recommendation 6: The Office should improve the management of its information and telecommunication technology by: (a) updating its server and/or server operating systems to a currently supported version; (b) changing its back-up system to one that supports automatic back-ups; and (c) performing yearly tests of its Disaster Recovery Plan as required.
Management action plan: (a) Server operating systems will be upgraded according to the recommendation before October 2016. The Office already contacted the Office of Information Management and Technology to purchase new licenses to complete the upgrade. (b) Back-up system will be replaced according to the recommendation before October 2016. New

equipment is currently being ordered.

(c) Disaster Recovery Plan will be tested on an annual basis.

Estimated completion date:

(a) 31 December 2016
(b) 31 October 2016
(c) 31 October 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 <u>not included in this report</u>.