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

MANAGED BY UNDP

(FISCAL YEAR 2015)

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Consolidated Report on the Audits of Sub-recipients of Grants from the Global Fund (FY 2015)
Executive Summary

Background

In December 2016, the Office of Audit and Investigations (OAI) concluded the review and analysis of audit reports of projects implemented by non-governmental organizations or government institutions that were Sub-recipients (SRs) of grants from the Global Fund for the fiscal year 2015 (FY 2015). 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's audit recommendations. The review covered 64 audit reports for FY 2015 that had been uploaded by Country Offices in the Comprehensive Audit and Recommendations Database System (CARDS) of OAI.

The 64 audit reports covered 64 SRs supporting 25 projects funded by the Global Fund in 16 of the 27 countries where UNDP was the Principal Recipient, the selection was based on OAIs audit criteria. The reports covered FY 2015 project expenses incurred totalling $53 million out of $104 million, equivalent to 51 percent of the overall UNDP/Global Fund SR expenses.[1] In terms of distribution, $39.5 million out of the $53 million, equivalent to 75 percent of the expenses audited, related to grants managed under the Additional Safeguard Policy.[2]

Results of the review

The auditors expressed unmodified audit opinions in all of the audit reports and over the total audited expenses. In the FY 2014 audit the auditors had expressed modified opinions on 0.6 percent of the audited expenses with a net financial misstatement of $21,463.

With respect to the external auditors' assessment of internal controls, the number of unsatisfactory ratings was low. The areas where the auditors found unsatisfactory internal controls were related to follow-ups on previous audit observations, human resources management, review of SR activity progress, procurement, cash management, and asset management.

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[1] The figure was based on the total amount recorded under the Government/NGO column of the Atlas-generated Combined Delivery Report.

[2] The Additional Safeguard Policy defined procedures and criteria for annual audits in a number of environments considered to be high-risk and was established by the Global Fund as part of its risk management processes.

The external audit firms raised a total of 254 audit observations in FY 2015, categorized by risk severity and by audit area, as follows:

- Risk severity: The 254 audit observations were categorized as: 29 (11 percent) high priority; 150 (59 percent) medium priority; and 75 (30 percent) low priority.
- Audit areas: The majority of the audit observations belonged to three core audit areas, namely: financial management; human resources selection and administration; and management and use of equipment/inventory. These accounted for 176 of the 254 (69 percent) audit observations.

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

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 2014) 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 30 high priority FY 2014 recommendations, 22 (73 percent) had been implemented, 4 (13 percent) had not been implemented and the remaining 4 (13 percent) were no longer applicable as of the end of 2016.

Policy development and guidance

During 2016, the Global Fund/Health Implementation Support Team, Health and Development Group within the Bureau for Policy and Programme Support continued to regularly monitor the outstanding advances to SRs through the Early Warning System and provide targeted support to Country Offices for the liquidation of outstanding advances. The Team prepared the SR management section of the Operations Manual, planned to be available online in late January 2017.

In addition to updates and revision of the guidance and tools currently included in the SR Management Toolkit, the new SR management section includes guidance on risk management in SR management as well as enhanced monitoring of key high-risk activities, such as training. Emphasis has been placed on providing guidance to Country Offices on monitoring the implementation of SR audit recommendations. The SR management tools are now integrated in the online Manual to complement specific management guidance. An SR monitoring visit checklist and capacity assessment tool were finalized in 2016.

In 2017, the Team shall enhance the capacity of Country Offices for SR management by delivering targeted workshops and trainings to roll out the new SR management tools and more broadly the added guidelines in the SR management section of the Operations Manual.

To support financial management, a webinar was given to Country Offices in 2016 on the new annual Global Fund reporting. Country Offices were supported to roll out the same training to the SRs. In November 2016, a regional workshop was organized for francophone Country Offices, topics included cash transfer modalities and best practices in the verification of SR expenditures. Also in 2016, an SR financial reporting template was developed and shared with new Country Office Principal Recipients (Afghanistan, Multi-Country Western Pacific and African Regional grant). The template will be rolled out to all Country Offices in 2017.

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1. Introduction

The Global Fund is a partnership organization and is designed to accelerate the end of AIDS, tuberculosis and malaria as epidemics. The Global Fund is a partnership between government, civil society and people affected by the diseases, and raises and disburses grant funds to support programmes in countries in need. As Principal Recipient, UNDP is accountable for the proper use of grant funds and the implementation of projects in recipient countries. UNDP may appoint SRs to implement part of the project activities that would otherwise be carried out by UNDP. The SR can be a governmental entity, a United Nations entity, or a non-governmental organization. SRs that are governmental entities or non-governmental organizations are required to be audited by external audit firms pursuant to the UNDP procedures for audits of projects under national implementation modality.

The total UNDP/Global Fund expenses for FY 2015 were $423 million. In 2015, project expenses incurred by SRs and audited under the non-governmental organization/national implementation modality audit process amounted to $53 million, with $39.5 million in Additional Safeguard Policy countries.

2. OAI role in Global Fund Sub-recipient audits

Each year, UNDP Country Offices that are Principal Recipients advise OAI of the SRs to be audited as part of their annual audit plans. Each SR selected is required to undergo an audit of its expenses, cash, and assets statements, and if the project is continuing, an assessment of its internal controls. The selection and audit of the SRs must be completed based on the criteria and the deadline established by OAI. The Global Fund/Health Implementation Support Team within the Bureau for Policy and Programme Support engages in Long-Term Agreements with external audit firms to improve the consistency and quality of the SR audits. The contracting of the audits and acceptance of the audit reports is a process owned by Country Offices. The audit reports of SRs are to be submitted to OAI for review after they have been clarified and accepted by the Country Office from the external auditors. 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 of the audit reports and specific content is uploaded by the Country Office onto CARDS, which is managed by OAI. OAI checks the quality of the data uploaded to CARDS.

3. Review of Global Fund Sub-recipient audits in FY 2015

In line with OAI criteria for the selection of SRs to be audited, 11 countries/regions did not require audits (Belize, Bolivia, Bosnia and Herzegovina, Djibouti, Guinea-Bissau, Multi-Country Western Pacific, Montenegro, Sao Tome and Principe, Programme of Assistance to the Palestinian People, Syrian Arab Republic, and Turkmenistan) specifically where:

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

The analysis of the audit opinions and audit observations of the 64 SR audit reports showed the following:

<u>Distribution of audit opinions</u>

The external audit firms were required to certify, express an opinion, and quantify the net financial misstatement 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 2015;

(b) the Certification on Statement of Cash Position as at 31 December 2015; and

(c) the Certification on Statement of Assets and Equipment as at 31 December 2015.

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

In FY 2015, the auditors expressed unmodified opinions in all of the audit reports and over the entire $53 million of expenses audited.

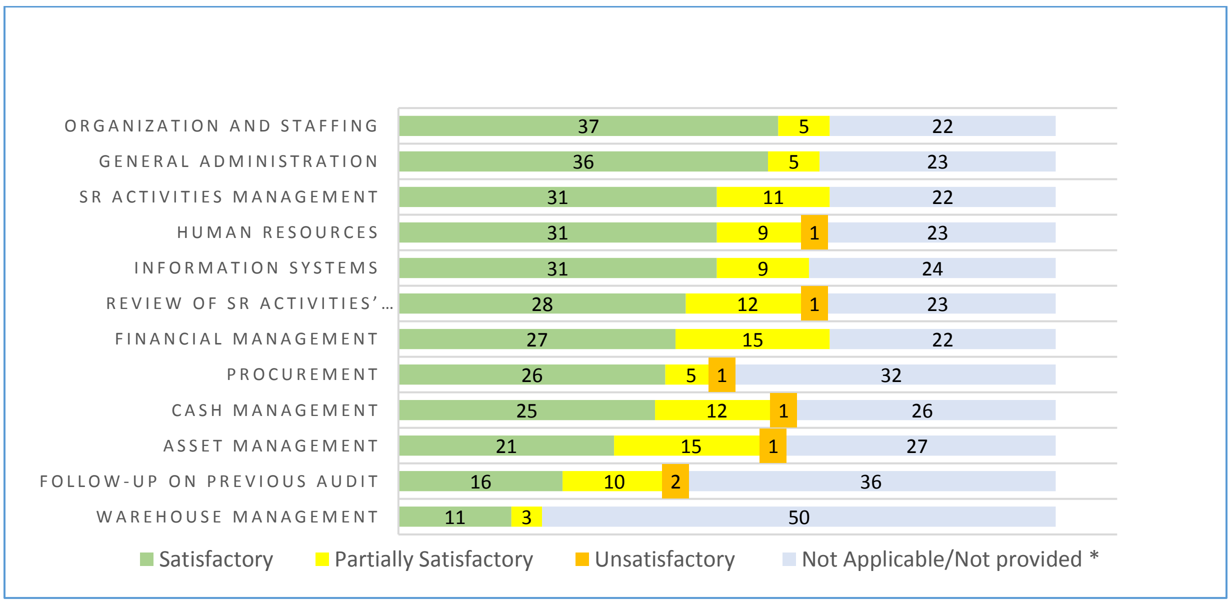
Rating of internal controls

The external auditors are also required to provide ratings of the internal controls of SRs according to the areas defined in the Terms of Reference. For FY 2015 the areas, organization and staffing, and general administration had most satisfactory ratings for internal controls.

While the number of unsatisfactory ratings was very low, the areas where the auditors found unsatisfactory internal controls were related to follow-ups on previous audit observations, human resources management, review of SR activity progress, procurement, cash management, and asset management.

Figure 1 presents the distribution of ratings on internal controls by audit area reviewed by OAI for the 64 SRs audited.

Figure 1: Distribution of rating on internal controls – FY 2015 (in absolute numbers)



Source: CARDS data

*The "not applicable/not provided" rating was mainly due to the following: (a) the rating of internal controls was not required for the Sub-recipients as the projects were coming to an end; or (b) an assessment of some of the areas was not undertaken because the SRs did not have any activities in those areas.

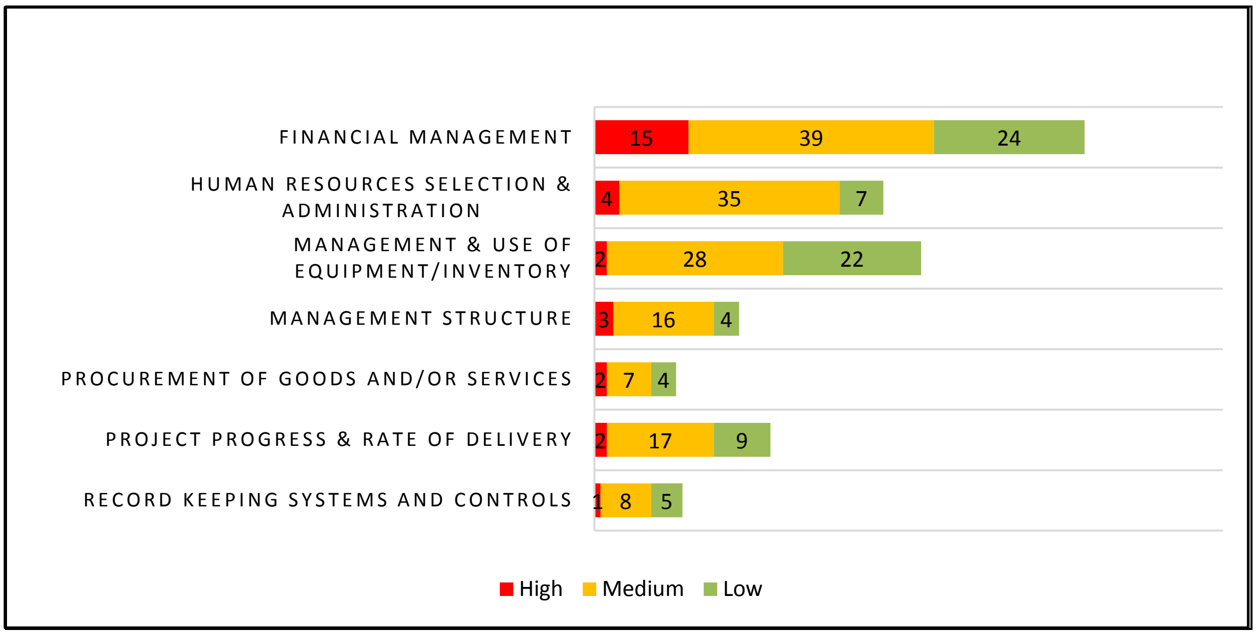
Audit observations and recommendations

For each SR audit, the external auditors were required to describe in a management letter internal control weaknesses noted. The management letter included the audit observations and recommendations, categorized the nature of audit observations by risk severity, and classified the audit observations and recommendations by audit areas. The external audit firms raised 254 observations and recommendations in the 64 SR audit reports for FY 2015. The reports were examined by OAI and the distributions of the audit observations and recommendations by risk severity and by audit area were as follows:

- Risk severity: The external audit firms classified the audit observations and recommendations in three categories, namely high, medium, or low. The 254 audit observations comprised of 29 (11 percent) categorized as high priority; 150 (59 percent) categorized as medium priority; and 75 (30 percent) categorized as low priority.
- Audit areas: The nature of audit observations and recommendations are categorized into seven audit areas as pre-determined by OAI in CARDS, namely (1) financial management, (2) human resources selection and administration, (3) management and use of equipment/inventory, (4) management structure, (5) procurement of goods and/or services, (6) project progress and rate of delivery, and (7) record keeping systems and controls.

The distribution by audit area and risk severity for the 254 audit observations/recommendations is shown in Figure 2 below.

Figure 2: Number of observations/recommendations per audit area and risk severity (254)



Source: CARDS data

Three core audit areas, namely (a) financial management, (b) human resources selection and administration, and (c) management and use of equipment/inventory accounted for 176 audit observations or 69 percent of total audit observations. With respect to financial management, the most common audit issue related to the lack of adequate accounting systems and controls, including misclassification of expenses, cheque handling errors, and weak supporting documentation. Regarding human resources selection and administration, the issues were mainly on poor management of contracts, salaries, and performance evaluations. Regarding management and use of equipment, issues were mainly on the lack of proper inventory and control systems.

4. Implementation of prior year audit recommendations

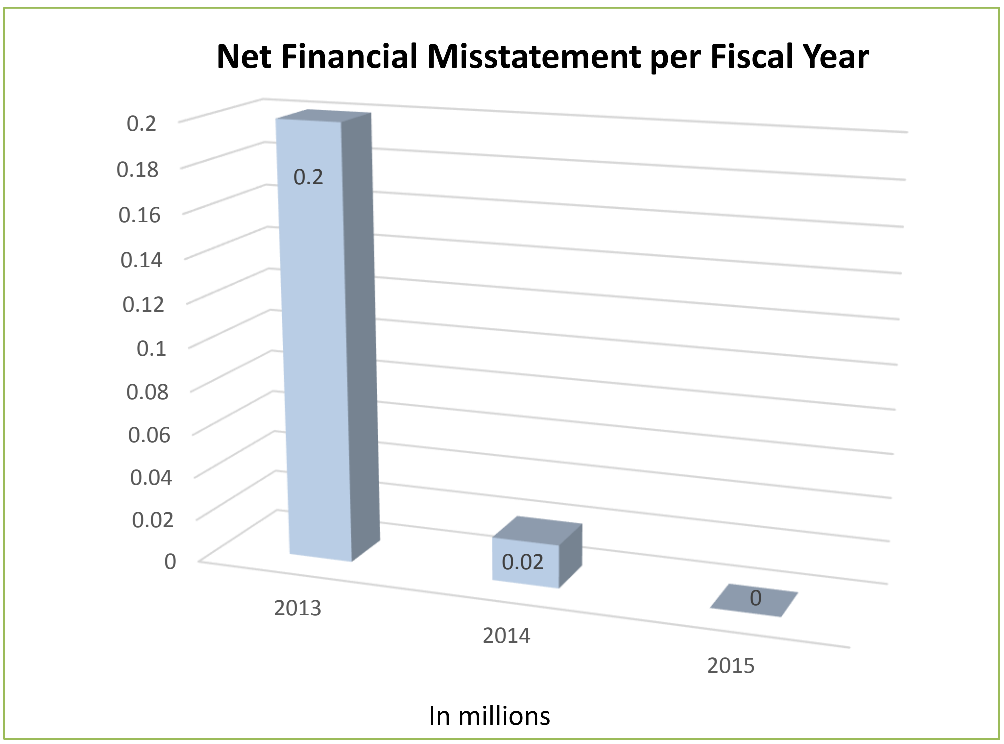
The external audit firms were required to review the progress achieved by the SRs in implementing the prior year's audit recommendations (FY 2014) and to report on the updated "action plans" (intended management actions to address the observations) for those recommendations. The Country Offices were required to upload and monitor the implementation status of the recommendations in CARDS.

OAI focused its assessment on the implementation status of high priority recommendations. Of the 30 high priority FY 2014 recommendations, the implementation status as of the end of 2016 was as follows: 22 (73 percent) had been implemented, 4 (13 percent) had not been implemented, and the remaining 4 (13 percent) were no longer applicable.

5. Net Financial Misstatement

The auditors expressed unmodified audit opinions in all of the audit reports and over the total FY 2015 audited expenses. This is an improvement from the FY 2014 audit exercise when the auditors had expressed a modified opinion on over 0.6 percent of the audited expenses with a net financial misstatement of $21,463 (see Figure 3).

Figure 3: Comparison of net financial misstatement of qualified opinions ($ million) (2013-2015)



Source: CARDS Data

Annex 1: Distribution of audit opinions in the Global Fund Sub-recipient audit reports for FY 2015

Country Office	Number of SRs audited	Audited SR expenses (in U.S. dollars)	Adverse		Qualified		Unmodified		Net Financial Misstatement current year
			# of SRs	Amount audited	# of SRs	Amount audited	# of SRs	Amount audited	
Afghanistan	4	1,058,911	0	0	0	0	4	1,058,911	0
Belarus	1	1,268,998	0	0	0	0	1	1,268,998	0
Chad *	1	-	0	0	0	0	1	-	0
Cuba	1	1,758,146	0	0	0	0	1	1,758,146	0
Haiti	15	7,989,092	0	0	0	0	15	7,989,092	0
Iran	2	2,011,324	0	0	0	0	2	2,011,324	0
Iraq	1	347,755	0	0	0	0	1	347,755	0
Kyrgyzstan	2	827,671	0	0	0	0	2	827,671	0
Mali*	5	-	0	0	0	0	5	-	0
Multi-Country South Asia (managed by the Asia and Pacific Regional Centre in Bangkok)	5	2,292,423	0	0	0	0	5	2,292,423	0
South Sudan	3	1,441,843	0	0	0	0	3	1,441,843	0
Sudan	2	957,133	0	0	0	0	2	957,133	0
Tajikistan	6	1,158,096	0	0	0	0	6	1,158,096	0
Uzbekistan	1	612,419	0	0	0	0	1	612,419	0
Zambia	3	4,428,143	0	0	0	0	3	4,428,143	0
Zimbabwe	12	26,766,986	0	0	0	0	12	26,766,986	0
TOTAL	**64**	**52,918,940**	**0**	**0**	**0**	**0**	**64**	**52,918,940**	**0**

Source: CARDS Data

* In Chad and Mali, the country offices operate under direct implementation for the SRs of Global Fund grants. No cash is transferred to the SRs. Therefore, only the management letter discussing the internal controls of the SRs was required for the audit exercise.

Annex 2: Definition of External Audit Opinions

Unmodified (Clean) Opinion (ISA15 700)

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

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

Qualified Opinion (ISA 705)

The auditor expresses a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Disclaimer of opinion (ISA 705)

The auditor disclaims an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Adverse Opinion (ISA 705)

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