AUDIT

OF

UNITED NATIONS CAPITAL DEVELOPMENT FUND

Report No. 2198
Issue Date: 14 May 2020
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Audit Report No. 2198, 14 May 2020: UNCDF
Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of the United Nations Capital Development Fund (UNCDF) from 17 February to 6 March 2020. 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 (planning and risk management, staffing, internal control framework and delegation of authorities and, business continuity and security);
(b) development activities (programme/project design, implementation and, administration); and
(c) operations (procurement, finance, human resources, administrative services and, information and communication technology).

The audit covered the activities of UNCDF from 1 January to 31 December 2019. UNCDF recorded programme and management expenses of approximately $77 million. The last audit of UNCDF was conducted by the United Nations Board of Auditors in 2019.

The audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing.

Overall audit rating

OAI assessed UNCDF as partially satisfactory/some improvement needed, which means “the assessed governance arrangements, risk management practices and controls were generally established and functioning, but need some improvement. Issues identified by the audit do not significantly affect the achievement of the objectives of the audited entity/area.” This rating was mainly due to deficiencies in the loan and guarantee policy, and weaknesses in the grant-making process.

Key recommendations: Total = 6, high priority = 2

The six recommendations aim to ensure the following:

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<tr>
<th>Objectives</th>
<th>Recommendation No.</th>
<th>Priority Rating</th>
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<tbody>
<tr>
<td>Achievement of the organization’s strategic objectives</td>
<td>3, 4</td>
<td>Medium</td>
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<tr>
<td>Effectiveness and efficiency of operations</td>
<td>6</td>
<td>Medium</td>
</tr>
<tr>
<td>Safeguarding of assets</td>
<td>5, 1, 2</td>
<td>Medium, High</td>
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For high (critical) priority recommendations, prompt action is required to ensure that UNCDF is not exposed to high risks. Failure to take action could result in major negative consequences for UNCDF. Both high (critical) priority recommendations are presented below:

- Deficiencies in the loan and guarantee policy (Issue 1)

The audit team noted that the policy did not specify at what point the various concentration risk limits should be considered (e.g., prior to a loan or a guarantee
approval), and therefore risk limits could be passed while the risk limits were not considered.

**Recommendation:** UNCDF should update its loan and guarantee policy so that adherence to the 30 percent threshold is considered before a loan or a guarantee is approved and that the corporate risk logs are duly updated in the event that a loan or guarantee that exceeds the established threshold is approved.

**Weaknesses in the grant-making process (Issue 2)**

The sourcing of grantees, the receipt and evaluation of grant applications, and then the selection of a grantee were carried out by the project team. This process did not provide for effective and efficient segregation of duties in the project team, according to best practices. Also, in all nine grants issued by the Financial Inclusion Practice Area (FIPA) and reviewed by the audit team, the submissions for review and endorsement to the relevant committees did not contain any information on the sourcing, solicitation and evaluation process of the grantees that had been undertaken by the project teams.

Moreover, the Technical Advisors/Project Managers participated in the selection process of grantees, including the setting up of the milestones to be met, before the disbursement; they were also involved in the monitoring and reporting on the status of these milestones and the management of disbursement requests of subsequent tranches released to the grantees.

**Recommendation:** UNCDF should implement procedures that ensure effective and efficient segregation of duties in the grant award and grant monitoring processes.

**Management comments and action plan**

The Executive Secretary, UNCDF, accepted all six recommendations and is in the process of implementing them. Comments and/or additional information provided have been incorporated in the report, where appropriate.

Low risk issues (not included in this report) have been discussed directly with management and actions have been initiated to address them.

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Helge Osttveiten  
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Helge S. Osttveiten  
Director  
Office of Audit and Investigations
I. About the Office

UNCDF was established in 1966 by the General Assembly with a unique mandate “to assist developing countries in the development of their economies by supplementing existing sources of capital assistance by means of grants and loans.” The mandate was modified in 1973 to focus on “first and foremost the least developed among the developing countries.”

UNCDF is headed by an Executive Secretary, who is accountable to the UNCDF Managing Director (UNDP Administrator). It has its Headquarters in New York with three Regional Offices: Dakar, Senegal; Addis Ababa, Ethiopia; and Bangkok, Thailand, as well as a Liaison Office in Brussels, Belgium. UNCDF performs programme activities in 45 countries.

At the time of the audit, the total number of staff in UNCDF was 251, with 57 staff members at Headquarters, 33 in the three Regional Offices, and 161 at the country level.

UNCDF is organized in service lines of which the two most important are as follows the Local Development Finance Practice Area (LDFPA) and the Financial Inclusion Practice Area (FIPA). The LDFPA consists of 110 staff members and focuses on promoting increased capital flow to the local level. FIPA consists of 106 staff members and focuses on promoting access to formal financial services for all segments of society, at a reasonable cost and on a sustainable basis.

UNCDF’s expenditures totalled $77 million during the audit period. The FIPA practice recorded programme and management expenditures totalling $32 million, the LDFPA practice recorded programme and management expenditures totalling $31 million, and the expenditure incurred by the other sections amounted to $14 million.

UNCDF’s existing Strategic Framework, covering the period 2018–2021, defined the following two strategic outcomes against which results would be monitored and measured:

- enhanced inclusive financial markets and local development finance systems that benefit poor and vulnerable populations and
- unlocked public and private finance for the poor.

In line with these objectives, UNCDF’s activities would target specific groups and geographies in least developed countries, such as:

- poor, underserved, and vulnerable populations experiencing sharp inequalities and exclusions in terms of access to finance, especially women and youth;
- small and medium-sized enterprises and financial service providers in need of finance to grow and stimulate local economies; and
- local governments in secondary cities, rural, and peri-urban areas.

In its Strategic Framework, UNCDF emphasized its aim to support the achievement of Sustainable Development Goal 1 (No Poverty), and 17 (Partnership for the Goals) by making finance work for inclusion, in collaboration with UNDP and other United Nations partners.

II. Audit results

OAI made two recommendations ranked high (critical) and four recommendations ranked medium (important) priority.
Low priority issues/recommendations were discussed directly and agreed with UNCDF and are not included in this report.

**High priority recommendations**, arranged according to significance:
(a) Update the loan and guarantee policy (Recommendation 1).
(b) Update the Operations Manual and guidelines related to the grant-making process (Recommendation 2).

**Medium priority recommendations**, arranged according to significance:
(a) Strengthen the management of loans (Recommendation 3).
(b) Designate a consolidated platform to report project/programme risks (Recommendation 4).
(c) Improve travel management (Recommendation 5).
(d) Establish a sustainable and efficient method to maintain the project monitoring tool (Recommendation 6).

The detailed assessment is presented below, per audit area:

### A. Governance

#### 1. Risk management

**Issue 1**  
**Deficiencies in the loan and guarantee policy**

The UNCDF loan and guarantee policy states that "In addition, there are reporting requirements on concentration risks. The following portfolio performance benchmarks will be reported upon: (1) country concentration, (2) sectoral concentration, (3) counterparty concentration and (4) currency concentration. If any of the mentioned categories exceed 30 percent of the portfolio, loan and guarantee respectively, reporting will be triggered and the Risk Management Group (RMG) of UNCDF will be informed. The LDC Investment Platform (LDCIP) team will be responsible for the reporting."

The audit team noted that the policy did not specify at what point the various concentration risk limits should be considered (e.g., prior to a loan or a guarantee approval), and therefore risk limits could be passed while the risk limits were not considered.

This situation might lead to potential financial losses for UNCDF should the countries, currencies or sectors with a higher concentration risk be negatively impacted.

<table>
<thead>
<tr>
<th>Priority</th>
<th>High (Critical)</th>
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<tbody>
<tr>
<td><strong>Recommendation 1:</strong></td>
<td>UNCDF should update its loan and guarantee policy so that adherence to the 30 percent threshold is considered before a loan or a guarantee is approved and that the corporate risk logs are duly updated in the event that a loan or guarantee that exceeds the established threshold is approved.</td>
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Management action plan:

Management agrees to introduce procedures to ensure information on concentration exposure is a regular part of the documentation reviewed at the time of new loan approval.

**Estimated completion date:** December 2020

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**B. Development activities**

**1. Projects administration**

**Issue 2**  
Weaknesses in grant-making process

UNCDF’s Operations Manual stipulates that “Detailed guidelines for each of the sourcing methods will have to be developed and must comply with the broader principles as outlined in this section.” Further, the Operations Manual suggests that the Request for Applications is the main method for sourcing grantees; however, other methods such as Partner Ranking and challenge calls could be used.

During FY2019, UNCDF booked grants worth $25.6 million compared to $15.1 million that had been booked in FY2018. The audit team reviewed 18 grants amounting to $10.4 million, or approximately 43 percent of the total grants held in FY2019, and noted the following:

Out of the 18 grants that were reviewed, the 9 grants that pertained to the FIPA practice were processed through a Request for Application process. The remaining nine grants were sourced under the LDFPA where a separate process based on a memorandum of understanding was used to facilitate the disbursement of the grants to local governmental entities.

a) Weaknesses in the process for the submission and processing of applications

UNCDF’s Request for Applications procedures for grants was provided as an annex to the Operations Manual, but lacked a description of the measures that needed to be taken to ensure effective and efficient segregation of duties, according to best practices, in the processing of the applications (i.e., receipt, opening, evaluation and selection of the successful applicant).

The audit team further noted that the sourcing of grantees, the receipt and evaluation of the applications, and then the selection of a grantee were carried out by the project team. This process did not involve the participation of a team or staff outside the project team (e.g., the Operations Unit).

Notwithstanding the segregation of duties in the approval process, with recommendations from the program manager submitted to the Investment Committee and furtherup in the reporting line, there were no measures within the project teams that would mitigate the possible misuse of the grant award process, whereby a grantee could be selected by the project team on the basis of considerations other than clearly established and well-defined criteria. In addition to segregation of duties, these measures may, for example, include (i) stamping the date and time of actual receipt of each application and recording it in a dedicated register to ensure that all applications are taken into account; (ii) precautions to preserve the...
integrity and confidentiality of all applications received; and (iii) a properly documented opening process so that all applications are considered by the evaluation team.

b) **Weaknesses in the grant endorsement process**

According to the guidelines, “The programme manager submits the recommendation to the relevant Programme Approval/Investment Committee for endorsement.” Yet the guidelines did not specify the documents and information to be submitted to the Committee for its review and subsequent endorsement. As a result, in all nine grants issued by the FIPA practice and reviewed by the audit team, the submissions for review and endorsement to the Committees did not contain information on the sourcing, solicitation and evaluation process of the grantees that had been undertaken by the project teams.

Further, the submissions for endorsement to the Committee were on a no-objection basis, and if no objection was issued within 14 days, a grant proposal was deemed to have been approved. In seven out of the nine grants issued by the FIPA practice, the Committee members required further information and clarification about the selection process; however, all nine grants were endorsed in the absence of a written and an explicit no-objection issued by the relevant Committee. According to UNCDF management, a new process that replaced the no-objection based approval has been implemented in 2020.

c) **Lack of segregation of duties in the grant monitoring process**

The grant disbursement related to 14 grants amounting to $9.6 million out the 18 grants amounting to $10.4 million were processed in two or more tranches.

The Technical Advisors/Project Managers were located in the countries where the grants had been issued and participated in the selection process of grantees, including the setting up of the milestones to be met before the disbursement. Further, they were also involved in the monitoring and reporting on the status of these milestones and the management of disbursement requests of subsequent tranches released to the grantees.

There is a risk of conflict of interest and lack of transparency in the engagement of grantees that might lead to misuse of the grant making-process, which will in turn negatively impact UNCDF’s ability to deliver its mandate and lead to diversion of UNCDF assets.

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<th><strong>Priority</strong></th>
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<td><strong>Recommendation 2:</strong></td>
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UNCDF should update the Operations Manual and the guidelines and implement procedures that ensure:

(a) effective and efficient segregation of duties in the grant award processes (i.e., the solicitation, the receipt, the evaluation and then the selection of grantees);

(b) a clear description of the review scope of the endorsement committees and the documents and information that should be provided to them so that their review is carried out in an effective manner; and

(c) proper segregation of duties over the grant monitoring process.
Management action plan:

Management believes that controls and segregation of duties are already in place at various levels throughout the project teams, Investment Committees, Practice Management, Head of Management Support Unit, Deputy Executive Secretary and final approval of the Executive Secretary for all grants.

While many of the OAI recommendations are in place, UNCDF will update its Operations Manual to ensure formalization of the business processes.

**Estimated completion date:** March 2021

**Issue 3**  
Weaknesses in management of loans

The management of loans should include several elements such as strategic goals translated to business plans to develop loan activities, documentation that all criteria that are met before disbursements are made and criteria to ensure that borrowers have not been involved with money-laundering or other type of financial crime.

Four loans amounting to $0.6 million, out of 13 loans amounting to $2.5 million were awarded during the audit period were reviewed and the following weaknesses were noted:

a) Various pieces of information about the borrowers were collected at the time the beneficiaries had received technical assistance and/or grants. Also, information on borrowers were provided in the Loan Paper and Credit Opinion as part of the scoring opinion. However, there was no evidence that information and data were gathered to check that the borrower was not, or had not been, involved in money laundering or another type of financial crime. Further, the UNCDF loan and guarantee policy did not stipulate the Know Your Client processes and procedures that need to be undertaken when onboarding potential borrowers.

b) Absence of documentation to demonstrate that the borrower had satisfied all the conditions listed in the Loan Agreement before loan disbursements could be made.

c) Apart from a list of priorities, UNCDF had not established a strategy and business plan to support its intent to develop its loan and guarantee activities.

Without a proper Know Your Client process, UNCDF might be involved with borrowers that are, or have been involved with, money laundering or another type of financial crime. Weak management of conditions precedent may impact UNCDF’s ability to efficiently administer the loan portfolio. Further, the lack of an established loan strategy and business plan may lead to an uncertain and unpredictable future on LDCIP’s priorities, thereby negatively impacting its ability to contribute to UNCDF strategic goals.

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<th>Priority</th>
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**Recommendation 3:**

UNCDF should strengthen the management of loans by developing and implementing:

(a) clear Know Your Client processes and procedures;
(b) a process that tracks conditions precedent, including the clearance signoff once these conditions have been met prior to the disbursement of the loan funds; and
(c) a strategy for the expansion of the loans and guarantees pipeline.
Management action plan:

(a) UNCDF agrees that while existing Know Your Client practices are well established, work processes and procedures need to be better explained and separately documented during the due diligence process. The investment memorandum and the policy will be updated to reflect this.

(b) UNCDF will strengthen the process in the policy to ensure compliance with conditions. As it implements a financial instrument management system in the near future, UNCDF will find ways to incorporate the compliance of conditions in the workflow prior to the disbursing of funds or provision of guarantees.

(c) UNCDF agrees to periodically review the vision and mission statement for LDCIP to ensure it adequately reflects the organization’s strategy.

Estimated completion date: June 2021

Issue 4  Multiple project risk registers

According to UNCDF’s Enterprise Risk Management policy, a risk register is defined as “A risk management tool that serves as a record of all risks identified by the unit. For each risk identified, it should include information such as likelihood, consequences, treatment options, etc.”

In four out of the five projects reviewed, there was no consolidated risk register where all the risks were recorded. The 2019 related risks were recorded in different platforms (i.e., UNCDF intranet, programme risk log, Atlas project module, Atlas grants module, and project reports).

UNCDF explained that the current systems allow the organization to track risks in different aspects of the business model.

This might lead to weak monitoring of the project risks.

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<td>Recommendation 4:</td>
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<tr>
<td>UNCDF should designate a consolidated platform to report the project/programme risks and the project teams should record and update the project/programme risk in the designated platform.</td>
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Management action plan:

Management understands the value of streamlining risk reporting under one platform. In line with the audit recommendation, management will review and define UNCDF Risk Management Platforms to formalize the arrangement and risk recording across the organization.

Estimated completion date: June 2021
C. Operations

1. Administrative services

**Issue 5**  Weaknesses in travel management

Business travel paid by the organization has to be approved before the traveller leaves for the trip and before any prepayments can be made. Furthermore, to have the lowest fare it is strongly encouraged to confirm travel itineraries as early as possible, and purchase (not only book) airline tickets at least 21 days in advance of travel when travelling in business class, and at least 14 days in advance when travelling in economy class.

In 2019, UNCDF issued 496 travel requests through the Atlas Travel and Expense module amounting to $1.6 million. Of these, 392 trips totalling $1.5 million related to travel undertaken by UNCDF staff, and 104 trips totalling approximately $180,000, related to travel undertaken by non-UNCDF staff (i.e., consultants and United Nations Volunteers).

Out of the 18 official travels reviewed, 10 had tickets valued at $133,088 (83 percent) that had been purchased less than two weeks prior to departure. Of these, there were three cases where the purchases had been finalized only one and two days before the travel date.

Also, all travellers are required to submit a travel claim through the post-travel report (F-10) to the authorizing unit within two weeks from completion of travel. The travel claim provides appropriate documentation that the travel occurred, enables the traveller to claim reimbursement of additional travel expenses and, should the travel advance exceed the amount of reimbursable expenses, enables the traveller to repay the amount of overpayment.

In the 18 sampled cases reviewed, there were 7 instances totalling $65,518 (41 percent) for which:

a. the F-10s had not been submitted at all (five cases).

b. the F-10 was submitted 47 days after the return date (one case).

This situation might lead to misuse of the organization's resources.

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<th>Priority</th>
<th>Medium (Important)</th>
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**Recommendation 5:**

UNCDF should improve travel management by:

(a) strengthening the review process of travel requests and clearing the backlog of outstanding F-10s; and

(b) purchasing tickets before, as applicable, 14 or 21 days of travel dates and limiting the purchase of tickets to less than these periods to only exceptional cases and

(c) complying with the travel policies with regard to submission of travel claims shortly upon completion of travels.

**Management action plan:**
On (a), management agrees with the recommendation. The recruitment of a Travel Associate is currently underway and all backlog created as a result of this vacancy will be fully cleared within three months of the onboarding. The roll out of the Travel and Expense module and assignment of traveller processors will further assist in timely processing of the travel claims.

On (b), additional measures will be put in place to improve the number of travels booked by UNCDF 14 or 21 days earlier as per the travel policy.

On (c), management agrees with the recommendation which has resulted due to a vacancy in the travel team. Management will ensure submission of travel claims are done as per the ‘UNDP Programme and Operations Policies and Procedures’ requirements.

**Estimated completion date:** December 2020

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**2. Information and communication technologies**

**Issue 6**  
**Sub-optimal set-up and use of Atlas**

As mentioned in its Strategic Framework for 2014 to 2017, whenever possible, UNCDF makes full use of UNDP’s systems, such as Atlas (UNDP’s enterprise resource planning system). Further, in its Strategic Framework for 2018 to 2021, it was mentioned that UNDP provides a range of operational and administrative support services to UNCDF in the areas of finance, procurement, human resource management, and information technology, including through its enterprise resource planning system (Atlas).

However, the Atlas set-up of projects implemented by UNCDF differed from the set-up used by UNDP, even though a large number of UNCDF’s projects were joint projects with UNDP and the size and nature of UNCDF’s operations did not justify a different set-up from that of UNDP.

The differences noted included the following:

- A separate project and outcome were created for each individual donor, leading to numerous projects and outcomes of a similar nature;
- The type of implementing partner (Institution Type) was not used, making distinguishing the implementation modality of the project difficult (e.g., directly or nationally implemented).

UNCDF created its own corporate monitoring and reporting tools and Financial and Procurement Snapshots, which were running during 2017 and 2018. However, 2019 data could not be reported in the UNCDF reporting tool despite follow-up with UNDP’s Office of Information Management and Technology since June 2019.

This situation might weaken the UNCDF’s capabilities of monitoring its activities.

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<thead>
<tr>
<th>Priority</th>
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<tr>
<td><strong>Recommendation 6:</strong></td>
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<tr>
<td>UNCDF should establish a sustainable and efficient method to maintain its project monitoring tool.</td>
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**Management action plan:**

Management agrees with the recommendation. UNCDF will continue to engage with the Office of Information Management and Technology to ensure re-establishment of a sustainable and efficient dashboard/project monitoring tool without further delay.

**Estimated completion date:** March 2021
Definitions of audit terms - ratings and priorities

A. AUDIT RATINGS

- Satisfactory
  The assessed governance arrangements, risk management practices and controls were adequately established and functioning well. Issues identified by the audit, if any, are unlikely to affect the achievement of the objectives of the audited entity/area.

- Partially Satisfactory / Some Improvement Needed
  The assessed governance arrangements, risk management practices and controls were generally established and functioning, but need some improvement. Issues identified by the audit do not significantly affect the achievement of the objectives of the audited entity/area.

- Partially Satisfactory / Major Improvement Needed
  The assessed governance arrangements, risk management practices and controls were established and functioning, but need major improvement. Issues identified by the audit could significantly affect the achievement of the objectives of the audited entity/area.

- Unsatisfactory
  The assessed governance arrangements, risk management practices and controls were either not adequately established or not functioning well. Issues identified by the audit could seriously compromise the achievement of the objectives of the audited entity/area.

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. Failure to take action could result in 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.