



AUDIT

OF

UNDP COUNTRY OFFICE

IN

SRI LANKA

Report No. 2321
Issue Date: 21 May 2021

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Report on the Audit of UNDP Sri Lanka Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of UNDP Sri Lanka (the Office) from 22 February to 12 March 2021. 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
- (b) Development activities
- (c) Operations – procurement, finance, human resources, administrative services, information communication and technology (ICT)

OAI designed six performance audit questions to guide the review of the following areas:

- (a) Governance
 - (i) Was the Office generating sufficient income to meet its operational costs and ensure its financial sustainability?
- (b) Development activities
 - (i) Were projects on track in achieving the planned output results?
- (c) Procurement
 - (i) Were procurement transactions being completed in a timely manner?
 - (ii) Was the Office adequately leveraging economies of scale in its procurement processes?
- (d) Financial management
 - (i) Were payments to vendors processed in a timely manner?
- (e) Human Resources
 - (i) Have recruitments been completed in a timely manner?

The audit covered the activities of the Office from 1 January 2020 to 31 January 2021. The Office recorded programme and management expenses of approximately \$19 million. The last audit of the Office was conducted by OAI in 2018.

The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. Due to the COVID-19 pandemic, the audit was conducted remotely. Scope limitations due to the nature of the remote audit related to the following activities:

- (a) A review of original supporting documentation could not be carried out, and therefore the audit team relied on scanned copies of documents provided by the Office for all audit areas reviewed.
- (b) Meetings with Office staff and personnel were carried out virtually, which limited the audit team's understanding of the Office's working environment.
- (c) Project visits (location, site visits, meeting with counterparts/beneficiaries) were not conducted.
- (d) A physical verification of assets was not performed.
- (e) Safe and petty cash contents were not verified.
- (f) The information communication and technology area was not reviewed on-site.

Overall audit rating

OAI assessed the Office's performance as **satisfactory/some improvement needed**, which means "The assessed governance arrangements, risk management practices and controls were 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 the Office's financial sustainability and project implementation challenges.

Key recommendations: Total = 4, high priority = 2

The four recommendations aim to ensure the following:

Objectives	Recommendation No.	Priority Rating
Achievement of the organization's strategic objectives	1, 3	High
	2	Medium
Compliance with legislative mandates, regulations and rules, policies and procedures	4	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. All high (critical) priority recommendations are presented below:

Office's financial sustainability at risk (Issue 1)

Between 2018 and 2020, the Office had experienced several challenges related to its financial sustainability:

- a) The Office was under-delivering against the expected \$20 million a year mainly due to a decline in donor funding. The Office programme delivery was \$18 million in 2018, \$17.7million in 2019 and \$16 million in 2020.
- b) The Office income decreased from \$2 million in 2019 to \$1.15 million in 2020 due low delivery.
- c) The staff costs between 2019 and 2020, were \$1.35 million and \$1.27 million, respectively, against a declining income.
- d) The Office's management costs represented 9.6 percent of the Office total expenditures, significantly above the 6.3 percent average ratio for a mid-sized Office in the Asia / Pacific region.

In addition to the above, the Office could face a delivery shortfall of 31 percent in 2021 due to funds withheld from the Green Climate Fund that could aggravate its financial sustainability.

Recommendation: The Office should mitigate the impact of financial sustainability by a) reducing its operating costs and align them with available resources or increase its revenue through higher delivery; and b) developing a risk mitigation strategy should the Green Climate Fund funding either be reduced, or not approved for disbursement.

Implementation challenges in a Green Climate Fund project (Issue 3)

The Integrated Water Management Project funded by the Green Climate Fund (GCF) was approved in June 2016. The audit team noted the following:

- (a) The project started in June 2017, a year after being approved by the GCF Board. As a result, the associated budget estimates based on the 2015 market data were outdated by the time the project initiated.

- (b) The budget figures presented by the responsible party in the project document were not verified by the Office at the time the project document was created.
- (c) In September 2019, the Office informed the Bangkok Regional Hub (BRH) that the budget allocated in the project document was much lower than the expected actual costs. The estimated budget shortfall was \$11.3 million.
- (d) In April 2020, the GCF was informed on the budgetary shortfall, seven months after the BRH was notified by the Office.
- (e) In August 2020, the GCF put on hold the disbursement of \$9.75 million, as per the signed agreement, pending GCF Board decision. The GCF Board was due to consider the full request in August 2021.

As a result of the above, the Office has been supporting the project activities, by utilizing its reserves. A mid-term evaluation was planned for mid-2021.

Recommendation: The Office in coordination with the Bangkok Regional Hub should strengthen its oversight by: a) establishing adequate quality assurance over the project design and communication processes to ensure the accuracy and validity of information contained in the project proposals, including budgets; and b) utilizing results from the mid-term evaluation to steer the project back on track and address the key risks and challenges in a timely manner.

Implementation status of previous OAI audit recommendations: Report No. 2008, 10 January 2019.

Total recommendations: 3

Implemented: 3

Management comments and action plan

The Resident Representative accepted all four 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.

Helge S. Osttveiten
Director
Office of Audit and Investigations

I. About the Office

The Office, located in Colombo, Sri Lanka (the Country) and its Country Programme covered the period 2018-2022 with the following development priorities:

- a) sustaining peace through more inclusive, effective and accountable governance;
- b) building resilience through integrated climate and disaster risk management; and
- c) building the data and knowledge foundations for evidence-based policy development.

During the period from January 2020 to January 2021, the Office spent \$17 million on development activities, a decrease by 16 percent compared to the previous period.

The largest development projects in terms of expenses during the period covered by the audit were:

Title	Expenditure Jan-Dec 2020 \$million	Expenditure Jan 2021 \$million
Integrated Water Management	5.4	0.7
Enhanced Local Governance	2.7	0.3
Achieving 2030 Agenda for Sustainable Development	0.5	0
Small Grants Project	0.5	0
Environmentally Sensitive Area Conservation	0.3	0.01
Total	9.4	1.0

The largest sources of funding of the Office's development activities for the period covered by the audit were:

Donor	Funding for the period \$million
European Union	1.3
Multi-Partner Trust Fund	1.1
Global Environmental Facility	0.9
UN Agencies	0.4
Total	3.7

Other critical information

A national lockdown due to the COVID-19 global pandemic interrupted the Office's operations between March and May 2020 as a number of government institutions and national implementing partners were unable to operate during this period. The Office implemented its business continuity plan during this time. In addition to this, parliamentary elections held in 2020 slowed down the government's operations, impacting on the implementation of projects.

II. Audit results

Satisfactory performance was noted in the following areas:

- (a) Operations-Procurement. A review of procurement functions, including samples of procurement transactions and management of individual contractors indicated that adequate controls were in place.
- (b) Operations-Human Resources. The review of human resources activities, including recruitment and separations disclosed that adequate controls were established and working effectively.
- (c) Operations-Information and communication technology. The Office's business continuity and disaster recovery plan had been tested and implemented satisfactorily during the audit period. No reportable audit issues were noted in the review of the ICT functions.

The assessment of performance audit questions was as follows:

(a) Governance

- (i) Was the Office generating sufficient income to meet its operational costs and ensure its financial sustainability?

In addition to the effects of the COVID-19 pandemic and the parliamentary electoral process in 2020 that affected the Office normal operations, the Office was showing a decreasing trend in its income generation due to mainly a reduction of donor funding, and consequently low delivery. The Office income decreased from \$2 million in 2019 to \$1.15 million in 2020. While staff costs in 2019 and 2020 were \$1.35 million and \$1.27 million, respectively, showing that income did not meet the Office staff costs in 2020. The Office's management costs represented 9.6 percent of the Office total expenditures, significantly above the 6.3 percent average ratio for a mid-sized Office in the Asia / Pacific region (Issue 1).

(b) Development activities

- (i) Were projects on track in achieving the planned output results?

The audit team identified delays in the implementation of activities related to the Green Climate Fund funded project (Issue 3). Six out of the seven projects sampled and reviewed were well on track in achieving their planned outputs.

(c) Procurement

- (i) Were procurement transactions being completed in a timely manner?

The audit concluded that the procurement transactions were processed in a timely manner and were completed on average within 48 days from the start of solicitation to contract signature. This was deemed reasonable considering that these actions relate to a period where operations were performed under the impact of COVID-19 pandemic.

- (ii) Was the Office adequately leveraging economies of scale in its procurement processes?

The Office leveraged the economics of scale through the inter-agency procurement initiatives of the UN business operations strategy (BOS). The Office has been the lead agency on a number of shared inter-agency long Term Agreements under the common BOS. The BOS is a results-based framework that focuses on joint business operations with the purpose of eliminating duplication, leveraging the common bargaining power of the UN and maximizing economies of scale.

(d) Financial Management

(i) Were payments to vendors processed in a timely manner?

The audit team assessed whether payments were made in a timely manner and completed within 30 days of receipt of invoices. Out of a total of 3,288 vouchers, with a value of \$13 million, processed during the audit period, there were 767 vouchers valued at \$2 million extracted from OAI's data analytics indicating there could be potential delays. From these 767 vouchers, the audit team selected; a sample of 20 vouchers with a total value of \$1 million for further review to identify if there was any systematic issue causing these delays. Delays noted were related to construction-type activities that required verification and quality check of the construction works prior to payment processing. The certification and receipt of construction works took on average from one to two months. However, once certified, payments were made within one and two weeks. The audit team concluded that payment delays in the sample reviewed were properly justified.

(e) Human Resources

(i) Have recruitments been completed in a timely manner?

The standard recruitment time established by the Office was 51 working days for fixed term appointments and 48 working days for service contract positions. During the audit period, the Office recruited 8 staff members under fixed term appointments and 31 service contract holders. A sample of 19 recruitments (6 fixed term appointments and 13 service contracts) was reviewed. The sample average lead time was 99 working days for recruitment of staff members, and 79 working days for service contracts. While these figures indicated a longer recruitment lead time, the recruitment of fixed term appointees was impacted by the re-profiling of the national officer positions in 2020 which accounted for 5 out of the 6 recruitments sampled. As a result, these national officer positions were on hold for several months before finalization. For service contracts, the delays were due to the COVID-19 pandemic, and the re-advertisement of vacant positions due to lack of qualified candidates. These cases were properly justified and therefore deemed non-reportable.

OAI made two recommendations ranked high (critical) and two 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, arranged according to significance:

- (a) Mitigate the impact of financial sustainability (Recommendation 1).
- (b) Strengthen its project oversight (Recommendation 3).

Medium priority recommendations, arranged according to significance:

- (a) Continue exploring new opportunities to accelerate resource mobilization efforts and intensify resource diversification (Recommendation 2).
- (b) Improve implementation of the Direct Project Cost methodology (Recommendation 4).

The detailed assessment is presented below, per audit area:

A. Governance

1. Financial sustainability

Issue 1 Office's financial sustainability at risk

The Office is required to align available funding with expected expenditures to ensure financial sustainability and operational continuity.

A restructuring of the Office was undertaken in 2017 to align it with the 2018-2022 country programme, and with the expectation that the Office would deliver \$20 million a year.

From 2018 to 2020, the Office had experienced several challenges related to its financial sustainability:

- a) The Office was under-delivering against the expected \$20 million a year mainly due to a decline in donor funding of 34 percent in 2020 (See Issue 2). The Office programme delivery was \$18 million in 2018, \$17.7million in 2019 and \$16 million in 2020.
- b) The Office income decreased from \$2 million in 2019 to \$1.15 million in 2020 due to low delivery.
- c) The staff costs from 2019 to 2020, were \$1.35 million and \$1.27 million, respectively, against a declining income.
- d) The Office's management costs represented 9.6 percent of the Office total expenditures, significantly above the 6.3 percent average ratio for a mid-sized Office in the Asia / Pacific region.

In addition to the above, the Office could face a delivery shortfall of 31 percent in 2021 due to funds withheld by the Green Climate Fund (see Issue 3) that could aggravate its financial sustainability.

The Office faces the risk of not being able to sustain the current staffing structure and operating costs unless income is substantially increased.

Priority	High (Critical)
Recommendation 1:	
The Office should mitigate the impact of financial sustainability by:	
<ol style="list-style-type: none"> (a) Reducing its operating costs and align them with available resources or increase its revenue through higher delivery; and (b) developing a risk mitigation strategy should the Green Climate Fund funding either be reduced, or not approved for disbursement. 	

Management action plan:

The Office re-commits to the following actions:

- a. As part of Office financial sustainability, the operating costs will be reviewed in the 2021 Country Office Business Plan (COBP) mid-term review with a view to agree on the next steps to address the issue, including possible strategic review.
- b. Following the Green Climate Fund (GCF) board discussions that will determine the future of the GCF project, the Office will update its financial sustainability strategy underlining risks outstanding with accompanying mitigation measures for discussion at the 2021 COBP mid-term review. Necessary actions will follow thereafter.

Estimated completion date: December 2021.

B. Development Activities

1. Country Programme

Issue 2 Lack of diversity in funding resources

The 'UNDP Programme and Operations Policies and Procedures' require Country Offices to establish effective partnership and resource mobilization action plans, identifying the required resources for programmes and projects, along with an analysis of the external resource environment to determine existing and potential new donors.

A review of the Office pool of resources identified a high dependency on a limited number of donors:

- a) The Green Climate Fund funded a single project that accounted for 46 percent of the 16 million total 2020 programme delivery.
- b) The government co-financing committed for the 2018-2022 country programme totaled \$28.4 million.
- c) The Office's expected resources for the next six months (Class A) consisted only of European Union resources for total of \$11.8 million.

To address funding challenges, in January 2021 the Office developed a Partnership and Communications Action Plan to guide the Office in enhancing resource mobilization efforts. The Office has also initiated discussions with private sector entities, government, and non-traditional donors.

Should the current downward trend continue, coupled with the uncertainties related to the release of funds by Green Climate Fund (Issue 3), the Office will be unable to achieve its development objectives.

Priority	Medium (Important)
Recommendation 2:	
The Office should continue exploring new opportunities to accelerate resource mobilization efforts and intensify resource diversification through government, non-traditional donors and private sector financing.	
Management action plan:	
The Office will execute its partnership strategy into hard pipeline targets, as per 2021 Country Office Business Plan, to diversify and build program and funding portfolio. The partnership strategy will focus on key existing and 'non-traditional' funding partners, including emerging donors, private sector, government and International Financial Institutions. The Office will continue to explore diversification with access to the joint UN funds as well.	
Estimated completion date: December 2021	

2. Project Administration

Issue 3 Implementation challenges in a Green Climate Fund project

A project document that meets UNDP's quality standards must be developed for all projects and contain a clear linkage to the programmes theory of change, outlining the causal relationship between the developmental challenge, activities undertaken, assumptions made and the overall output result.

The Integrated Water Management project (project No. 57445) funded by the Green Climate Fund (GCF) and implemented by the Government of Sri Lanka with implementation support provided by the Office, was approved by the GCF Board in June 2016. The project duration was set for seven years.

The audit team noted the following weaknesses in budgeting and timely responses to delays:

- (a) The project started in June 2017, a year after being approved by the GCF Board. As a result, the budget based on the 2015 market data was outdated by the time the project started.
- (b) Under Output 2 of the project, the government re-allocated the originally identified water sources to other entities, resulting in the project having to use water sources that were more costly.
- (c) The budget figures presented by the responsible party in the project document were not verified by the Office at the time the project document was created, thus there was no assurance of the reasonability of the estimated budget for Output 2.
- (d) In September 2019, the Office informed the Bangkok Regional Hub (BRH) that the budget allocated in the project document was much lower than the expected actual costs. The estimated budget shortfall was \$11.3 million.
- (e) In April 2020, the BRH informed the GCF on the budgetary shortfall. Subsequently, in May 2020 the GCF requested additional information which was provided five months later in October 2020.

- (f) In August 2020, the GCF put the disbursement of \$9.75 million on hold, as per the signed agreement, pending GCF Board decision. In the meantime, the Office through its reserve funds has supported the Project Management Unit (PMU) staffing costs. In March 2021, the GCF agreed to release a partial tranche of \$1.8 million to maintain the PMU and existing commitments and to undertake the planned mid-term evaluation of the project. The GCF Board was due to consider the full request in August 2021.

Weaknesses in the budget estimation and timely communication could lead to weakness in the partnership relations with donors and undermine the programme results of the Office.

Priority	High (Critical)
Recommendation 3:	
The Office in coordination with the Bangkok Regional Hub should strengthen its project oversight by:	
<ul style="list-style-type: none"> a) Establishing adequate quality assurance over project design and communication processes to ensure the accuracy and validity of information contained in the project proposals, including budgets; and b) utilizing results from the mid-term evaluation to steer the project back on track and address the key risks and challenges in a timely manner. 	
Management action plan:	
The Office agrees with the recommendation and will take the following action:	
Roll out and finalize the mid-term evaluation of the Green Climate Fund (GCF) project by end May 2021; based on the recommendations of the mid-term evaluation, the decisions of the GCF board on the future of the GCF project, and guided by the 2021 Country Office Business Plan mid-term review discussion take necessary actions.	
Estimated completion date: December 2021.	

C. Operations

1. Finance

Issue 4 Direct Project Cost charges not adequately implemented

The 'UNDP Programme and Operations Policies and Procedures' require Direct Project Cost (DPC) charges to be well-supported and be directly attributed to actual costs.

DPC charged to projects in 2020 amounted to \$395,388. The Office was unable to properly justify the DPC charges through its standalone project and did not provide the adequate supporting documentation:

- (a) The required minimal quarterly reconciliation of DPC costs against budgets amounts was not performed.

- (b) There was no self-assessment of staff workload supporting and documenting the staff support time allocated to each project. The Office's internal DPC Standard Operating Procedures require programme staff and common staff support costs to be calculated using quarterly timesheets; these were not utilized.
- (c) The Office did not update the Local Price List annually as required.

The Office risks over or under-charging DPC to projects either subsidizing or overcharging projects.

Priority	Medium (Important)
Recommendation 4: The Office should improve implementation of the Direct Project Cost methodology by: <ul style="list-style-type: none"> a) performing quarterly reconciliations of DPC charges and undertaking revisions where necessary; b) preparing self-assessment reports and quarterly timesheets to reflect significant changes in the actual workloads against the costs attributed to the projects; and c) annually updating the local price list, in addition to maintaining sufficient service volume information for its quarterly billing charges. 	
Management action plan: The Office management agrees with the recommendation and will undertake the following actions: The Office will review services rendered by personnel to projects that would enable accurate recovery of DPC. Further, the standard operating procedures in place since January 2021, will ensure compliance with UNDP policy on the Direct Project Cost recovery. Regular quarterly billing and verification measures will also be undertaken. Estimated completion date: December 2021.	

Definitions of audit terms - ratings and priorities

A. AUDIT RATINGS

- **Fully 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.
- **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.