Summary

The Office of Internal Audit and Investigations (OIAI) has conducted an audit of the Division of Financial & Administrative Management (DFAM) Treasury Management for the period January 1, 2011 to December 31, 2012. The audit sought to assess the governance, risk management, and control processes over Treasury management. The audit was conducted between 25 February and 9 May 2013.

Treasury Management strives to identify, manage and mitigate financial risks to which UNICEF is exposed, while at the same time generating a market return on its liquidity. These risks are primarily related to maintaining adequate liquidity while managing investments and foreign exchange fluctuations.

UNICEF has a Financial Advisory Committee (FAC) consisting of internal staff members of UNICEF whose responsibilities do not include daily interaction with financial markets. The FAC advises Treasury Management with respect to investment strategies and performance benchmarks. The committee approves bank and counterparty relationships and limits, investment guidelines and treasury policies.

UNICEF is voluntarily funded and does not have the authority to borrow funds for purposes of covering cash flow deficiencies or to leverage its cash position. The Treasury Management manages funds liquidity to ensure that operating cash-flow requirements are met. Funds not immediately required for operations are invested in a manner designed to preserve capital and ensure sufficient liquidity, while earning a rate of return commensurate with the conservative risk tolerance defined by the Financial Advisory Committee.

In 2011-2012, the Treasury Management was responsible for: managing more than US$ 4.0 billion in annual UNICEF receipts and disbursements; transacting more than US$ 5.4 billion in foreign currency trades (US$ 2.6 billion in 2011 and US$ 2.8 billion in 2012); and managing on average US$ 3.0 billion (US$ 2.9 billion in 2011 and US$ 3.3 billion in 2012) in investments. Total revenues generated by investment activity and foreign currency trading strategies were US$ 47.6 million in 2012 and US$ 32.1 million in 2011.

The Treasury Management manages 13 convertible currencies and is responsible for foreign currency replenishments for country offices. In 2011, 26 currencies were purchased for 31 country offices; and 70 currencies were purchased for 82 country offices in 2012. In 2012, about 63 percent of the funds received were in United States dollars (US$), with 37 percent in other currencies. Ninety percent of disbursements were made in US$ and 10 percent in other currencies.

Action agreed following audit

As a result of the audit, and in discussion with the audit team, DFAM has decided to take a number of measures, including two to address the following high-priority issues:

- Overall, the principal weakness and opportunity for improvement in Treasury Management operations results from a lack of adequate technology. This creates unnecessary manual work, reducing the time available for more critical tasks. Technology difficulties and limitations have diminished Treasury Management's ability to optimize investment portfolio returns and manage account balances, due
to a lack of cash forecasting tools. Further, senior management oversight over the effectiveness of risk mitigation controls has been hindered by the inability to efficiently produce compliance reports.

- There were 140 returned payments in 2011 for a total of US$ 3.4 million, and 171 in 2012 totalling US$ 1.7 million, because of incorrect payment instructions. This happened because of the decentralization of the Vendor Master Database and inadequate controls over payroll payment instructions. It is recommended that control measures be ensured over the vendor master database (including consideration of the centralization of the vendor database) and that payroll payments be subject to pre-notification entry.

Conclusion
The audit concluded that overall, subject to implementation of the agreed actions described, the controls and processes over UNICEF’s Treasury Management were generally established and functioning during the period under audit. The measures to address the issues raised are presented with each observation in the body of this report.

DFAM has prepared action plans to address the issues raised, and will work with OIAI to monitor implementation of these measures.

Office of Internal Audit and Investigations (OIAI) July 2013
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Objectives and scope

The objective of an audit is to provide assurance as to whether there are adequate and effective controls, risk-management and governance processes over a given area. The specific objectives of the Treasury Management audit were to determine whether:

- risks were appropriately assessed and managed;
- governance processes were well-designed and functioning well;
- UNICEF financial assets were safeguarded;
- control processes were appropriate and sufficient;
- sufficient liquidity was maintained for day to day operations;
- investment portfolio returns were optimized;
- investments and related transactions were in compliance with applicable UNICEF regulations and rules; and,
- reporting over treasury performance was accurate against established benchmarks.

The audit covered the period 1 January, 2011 to 31 December 31, 2012. For each objective, there is a brief explanation of the audit coverage; between them, these define the scope of the audit.

Audit observations

1 Risk management

In this area, the audit established whether treasury risks are identified, policies and procedures are implemented to manage identified risks, and risk mitigation policies and procedures are monitored.

Satisfactory key controls

The audit found that controls were functioning well over a number of areas in risk management, including (but not necessarily limited to) the following:

UNICEF has developed and documented comprehensive policies and procedures designed to effectively identify and manage operational and global risks arising from cash balances and investments, foreign exchange, and potential misappropriation. UNICEF’s policies and guidelines are designed to mitigate market, credit, interest rate, liquidity, foreign currency rate and counterparty risks, and to monitor compliance with these guidelines.

UNICEF has a comprehensive foreign currency risk management strategy that uses structured investments and forward contracts to mitigate exchange and translation risks. Treasury Management monitors its risk mitigation efforts by: measuring gains and losses on foreign currency translation and transactions; analyzing performance for sales and
purchases of foreign currency against Bloomberg\(^1\) average exchange rates; and measuring the incremental value realized with centralization of foreign currency purchases for country offices.

UNICEF’s investment policy prescribes that up to 10 percent of the investment portfolio may be comprised of structured deposits. Structured deposits, which have been used by UNICEF since 2003, are subject to investment diversification and counterparty risk guidelines provided in The Treasury Cash & Investment Management Guidelines and Procedures.

UNICEF uses structured deposits as an investment vehicle to manage foreign currency risk and operational cash flow requirements, and to enhance investment yield. A structured deposit is a time deposit placed with an approved counterparty. At the time of the deposit, UNICEF sells the counterparty an option to return the principal and interest on the deposit in an alternative currency at a specified price. The option purchased allows the counterparty to pay in either currency upon maturity. The yield on these investments improves because income earned includes both interest on the deposit and the option premium.

Foreign currency (FX) open exposure limits have been established to limit risk and are regularly reviewed by the Financial Advisory Committee. UNICEF’s guidelines prohibit foreign currency trading for speculative purposes. FX transactions may be undertaken only to meet actual and anticipated receipts and disbursements. The audit did not note any exceptions to the established limits during compliance testing.

UNICEF’s investment policy defines best practices for management of the portfolio structure with respect to interest rate, counterparty, market and liquidity risks. Investment guidelines prescribe the investment procedure, return benchmarks and performance calculations and reporting.

Business Continuity Plan (BCP) processes have been developed and are well documented, addressing all operational areas. The plan is updated on a regular basis and has been tested.

**Quantitative risk analyses**

Although risks had been identified and managed, quantitative risk analyses were not performed. International Public Sector Accounting Standards (IPSAS) 30, effective beginning January 1 2013, requires quantitative disclosures, including sensitivity analysis of market, credit, and liquidity risks, and qualitative disclosures for each type of risk arising from financial instruments. Disclosures must include information regarding risk exposures, how they arise, and the objectives, policies, and processes for managing the risk. However, data currently available through SAP (VISION)\(^2\) did not provide the tools to meet these disclosure requirements.

Treasury Position and Limits Compliance Reports had been produced infrequently and had not been promptly distributed. Limits Compliance was monitored daily based on reported SAP balances. However, due to a lag in the timing of bank reconciliations and SAP

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\(^1\) Bloomberg is an on-line subscription service that provides real-time global financial and market data, news and analytics to over 315,000 professional financial subscribers.

\(^2\) VISION is UNICEF’s SAP enterprise management system. It is fairly new, having been implemented in January 2012.
programming errors, there had been data integrity issues with SAP reported balances, rendering them unreliable. Prior to producing the Treasury Position and Limits Compliance Reports, Treasury Management performed a preliminary reconciliation of SAP balances to bank reported balances, and adjusted SAP balances to ensure accurate reporting. Because the reconciliation process was a labour-intensive task, requiring several hours daily, there were insufficient resources to complete this task as needed. Reports should be prepared and provided to the Comptroller on a weekly basis. In 2011, there were 35 reports produced but in 2012, only 17 reports were produced. The distribution of these reports was frequently several weeks after the reporting period ended.

SAP modules for calculating portfolio performance and structure, monitoring counterparty credit ratings, measuring financial risk and foreign currency exposures had not been implemented for VISION. The transition from UNICEF’s previous management system, PROMS, to VISION on 1 January 2012 was not effectively implemented in that respect and, as a result, previously available data used to assess and manage risk was no longer available from SAP. This resulted in inaccurate reports from SAP that required manual validation of data against external reporting sources (i.e., bank reports) and manual data calculations to produce accurate Treasury Position and Limits Compliance Reports. There had been ongoing efforts by the Division of IT Solutions and Services (ITSS) to correct the programming errors, but there was no resolution as of completion of the audit.

**Agreed action 1 (high priority):** The Division of Financial and Administrative Management agrees to, with the support of the Division of IT Solutions and Services, ensure that VISION configuration and reporting issues are resolved in a timely manner and that disclosure requirements are automated. To this end, DFAM should assess the need for additional SAP technological expertise.

Responsible staff: Senior Financial Management Specialist, Treasury.
Date by which action will be completed: March 2014

**Agreed action 2 (medium priority):** UNICEF’s Treasury Management agrees that it will explore alternative treasury technology software to provide the automation required to meet its treasury management requirements efficiently and accurately. A cost-benefit analysis will be conducted to evaluate the efficacy of an integrated treasury management system within SAP compared with stand-alone software solutions interfaced with SAP.

Responsible staff: Senior Financial Management Specialist, Treasury.
Date by which action will be completed: March 2014.
2 Governance processes

The audit tested whether the governance processes were well-designed and functioned well. The audit established whether there was an oversight body that established investment guidelines and acceptable counterparties, and approved treasury policies. The performance of the oversight body was also reviewed with respect to advice and monitoring responsibilities over investment strategies and performance benchmarks.

Financial Advisory Committee membership

UNICEF has an established Financial Advisory Committee (FAC) which advises the Treasury Management with respect to investment strategies and performance benchmarks. The FAC also approves bank and counterparty relationships and limits, investment guidelines and treasury policies. The Terms of Reference for the FAC clearly define the purpose, membership, responsibilities and authority of the panel, as well as establish guidelines for decision making and conducting FAC business. A review of the minutes of the Financial Advisory Committee found that the FAC members were discharging their responsibilities.

The FAC Management Report (Financial Overview and Treasury Performance) is presented to the FAC at each meeting and discussed at length. The report includes the list of counterparties to be approved, variance analysis of year to year performance, performance against benchmarks and other relevant financial and treasury information.

Several of the FAC members were knowledgeable about the world money markets, the economic environment and risk management. However, the members were internal members of UNICEF whose responsibilities did not include daily interaction with financial markets to the extent that Treasury Management personnel are exposed. The Terms of Reference (ToRs) for the FAC require that two members of the committee be external to UNICEF, with expertise in financial markets and investment management. The FAC had agreed upon ToRs for external membership but had not selected candidates for the position. Discussions with DFAM management indicated that though the ToRs of the FAC indicated that there should be two external members, the FAC was considering selecting one external member only.

The FAC Management Report is an integral part of the FAC business agenda but only some of the information presented in the report was included in the official minutes of the meetings. The FAC Management Report is a lengthy document containing a number of tables and charts. Inclusion of text of the Report into the minutes would require duplicate effort to produce and is unnecessary. Such information can however be incorporated into the minutes by reference.

Agreed action 3 (medium priority): The Division of Financial and Administrative Management agrees to:

i. Identify and recruit suitable candidates to fill external membership in the Financial Advisory Committee.
ii. Ensure that the FAC minutes incorporate by reference the FAC management reports.

Responsible staff: Deputy Director, Finance, DFAM and the Financial Advisory Committee.
Date by which action will be completed: December 2013.
3 Safeguarding of financial assets

The audit determined whether investment quality, safety and liquidity were stressed over rate of return; whether risks were managed and monitored on a regular basis; and whether processes, policies and procedures to minimize losses had been implemented.

Satisfactory key controls

Comprehensive treasury and cash management policies and procedures were established that were consistent with risk mitigation. Risks were appropriately identified, and procedures and reporting implemented, to effectively manage investment and foreign currency exchange risks. Treasury Management was skilled in use of external resources, such as Moody’s credit ratings, 360T Trading Networks, and Bloomberg services to monitor counterparty and market risks.

UNICEF has a comprehensive FX risk management strategy which uses structured investments, competitive bidding and forward contracts to mitigate exchange and translation risks. Treasury Management monitored the actual transaction exchange rate against Bloomberg’s average exchange rates on an annual basis with a positive variance of less than 1 percent for 2011 and 2012. Further, Treasury Management realized net FX gains of US$ 4.9 million in 2011 and US$ 18.8 million in 2012.

In 2011, only two foreign payments were returned for non-compliance with Office of Foreign Assets Control (OFAC) guidelines and controls; none at all were returned in 2012.

Treasury Management had developed a comprehensive analysis of its risk management and reporting technology requirements. It had created a Business Blueprint that detailed its plan for improved capabilities in managing: liquidity and investment management responsibilities; daily cash management transactions; reporting, accounting and analysis tasks; and compliance reporting.

During 2012, Treasury Management initiated weekly meetings with ITSS to identify technical and programming problems within VISION. A conflict resolution log was maintained that tracked each programming and reporting issue and its status.

Returned payments

In 2011, 140 payments totalling US$ 3.4 million were returned to UNICEF as a result of incorrect payment instructions; in 2012 there were 171, totalling US$ 1.7 million. Although representing less than 1 percent of all payments, each of these misdirected payments was

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3 Moody’s ranks the creditworthiness of borrowers using a standardized ratings scale which measures expected investor loss in the event of default. Moody’s Investors Service rates debt securities in several market segments, including government, municipal and corporate bonds; managed investments such as money market funds, fixed-income funds and hedge funds; financial institutions including banks and non-bank finance companies; and asset classes in structured finance.

4 360T is a multi-bank/multi-asset on-line trading platform bringing together more than 125 market makers providing prices in all currency pairs; this service is used to obtain the most competitive pricing for FX transactions.
represents a potential loss of funds (e.g., funds inadvertently delivered to the wrong account may not be recoverable).

Payment instructions for these transactions are included in the Master Vendor File and the Payroll databases. The errors had occurred because of the decentralization of the Vendor Master Database, and also because of poor quality controls; these had resulted in incorrect and duplicate payment instructions for payroll payments. DFAM indicated that it could not on its own make decisions on decentralization or centralization of the creation of master vendor records, and quality-control responsibilities would currently require involvement of other divisions, such as Supply Division and ITSS. In the case of payroll, DFAM indicated that payroll payments were initiated from the Division of Human Resources (DHR).

**Agreed action 4 (high priority):** DFAM, in conjunction with the VISION Steering Committee, agrees to ensure that the quality control measures for Vendor Master Database maintenance are strengthened, and consider the centralization of this function. To this end DFAM should consider scrubbing the Vendor Master database, to eliminate duplicate vendor records and validate payment instructions. Invalid Transit Routing Number errors would be eliminated by the use of a validation routine to match data input against a published list of valid Transit Routing Numbers.

Responsible staff: Working Group 1 and Deputy Director Finance, DFAM.
Date by which action will be completed: September 2013 for the GMT recommendation.

**Agreed action 5 (medium priority):** DFAM agrees, in conjunction with the Division of Human Resources, to ensure that direct deposits of payroll disbursements are subject to a pre-notification entry. This notification will permit timely contact with the employee to ascertain the correct payment information prior to the transmission of a payroll disbursement.

Responsible staff: Finance Manager, Field Financial Management Unit
Date by which action will be completed: March 2014.

**Banking fees**
Beginning in 2011, the Field Financial Management Unit (FFMU), which is responsible for banking relationships, began monitoring and measuring bank fees; however, FFMU had no conversations with JPMorgan Chase Bank about specific charges, and UNICEF did not attempt to negotiate a reduction of fees during the audit period. As a result, unnecessary banking charges were incurred. For example:

**Premium charges for investment:** Approximately 5 percent of wire transfers (65 per month) required repair (adjustment) by Chase Bank prior to execution, which resulted in a US$ 2 per item premium charge for processing the payment. The instances of wire repairs were brought to the attention of FFMU during the audit; this prompted FFMU to make inquiries with Chase. They learned that the probable cause for the needed repairs was that, although UNICEF was transmitting the correct data to Chase Bank, the Chase program was likely mapping the data to the wrong SWIFT (Society for Worldwide Interbank Financial Telecommunication) message field.

**Sweep services:** In February 2013, the fee for overnight sweep services was US$ 225, and the interest realized on the funds invested overnight did not cover the cost of the service. In February 2013 JPMorgan was asked to discontinue the service.
Single European Payments Area (SEPA): SEPA is a payment system that eliminates differences between domestic and cross-border euro transactions throughout the eurozone. SEPA provides improved and cheaper payment services, with payments being credited within one working day. UNICEF, however, executed euro payments not through SEPA but from Chase London accounts. The transactions were transmitted as wire transfers to Chase through their PaySource™ interface via SWIFT. Wire transfer fees charged by Chase are US$ 6; estimated SEPA fees are US$ 0.29. On average, 420 payments per month were sent to countries in SEPA. Potential annual savings for replacing wires using the SEPA system are about US$ 30,000. At the time of the audit, UNICEF was developing the required expertise necessary to convert wire payments to SEPA payments.

Agreed action 6 (medium priority): DFAM agrees to:

I. Conduct a detailed review of monthly bank fees for reasonableness; this will form the basis for periodic meetings with bank relationship officers to discuss banking services and fees.

II. Ensure that the Field Financial Management Unit continues to work with the Division of IT Solutions and Services to implement euro payments via the Single European Payments Area payment format.

Responsible staff: Senior Financial Management Specialist and Finance Manager.
Date by which action will be completed: September 2013 first review, to be followed up on a regular, quarterly basis for action (i), and March 2014 for action (ii).

Bank balances
Country office’s banks generally did not have credit ratings conducted by agencies such as Moody’s, Fitch, or Standard and Poor’s. Treasury Management had therefore developed a template to evaluate the financial strength of unrated banks. Prior to opening a new bank account, a credit review was performed using the data entered into the template, which evaluates the proposed bank’s financial strength against its peers.

Once the account was open, however, there was no consistent process to periodically evaluate the bank’s financial strength. As a mitigating control, country office accounts were maintained with minimal balances. Compliance with these limits was the responsibility of the country offices. The audit noted that 40 percent of the account balances held at the country offices exceeded the defined deposit limits. A report previously being used by country offices to monitor their bank balances against prescribed limits was not being used during 2012.

Agreed action 7 (medium priority): The Division of Financial and Administrative Management agrees to establish a process to monitor account balances against established limits for all bank accounts operated by UNICEF on a real-time basis.

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5 SEPA currently comprises 32 countries: the 27 member states of the European Union, three member states of the European Economic Area (Iceland, Norway and Liechtenstein), and Switzerland and Monaco.
Bank agreements

Many country offices did not have written agreements with their banks. This could lead to difficulties for UNICEF in protecting its interests in the event of litigation. Further, several of the existing agreements did not include special UN provisions with respect to the privileges and immunities afforded UN agencies, nor did they provide for United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules. The FFMU conducted a survey in 2011 to identify which country offices did not have agreements with their banks, and was planning to contact these country offices to have them negotiate such agreements. This plan had not been implemented at the completion of the audit.

Agreed action 8 (medium priority): The Division of Financial and Administrative Management agrees to:

- Ensure that for all banking relationships with global providers, there are written agreements with financial partners consistent with UN terms and conditions.
- Establish, to the extent possible, depository accounts with global and regional financial institutions, rather than local banks for country office operational and private sector donor accounts.

Responsible staff: Senior Financial Management Specialist and Deputy Director, Finance, DFAM.

Date by which action will be completed: March 2014 and then ongoing.
4 Appropriateness and adequacy of control processes

In this area, the audit established whether the control environment reinforced the importance of internal controls as evidenced by risk assessment and control activities. It sought to determine whether procedures were in place to monitor that controls were operating as intended and information and performance reporting established accountability for compliance with established policies and procedures.

Satisfactory key controls
There was strong internal control awareness in Treasury Management and an awareness of the risks. There was also a strong personnel development effort to ensure staff members had the support and knowledge needed to recognize risks and make informed decisions and recommendations.

Segregation of duties, authority and responsibilities for Treasury Management personnel were clearly documented in the *Treasury Cash & Investment Management Guidelines and Procedures*. The Treasury Management group was divided into two functions, which provided for segregation of incompatible duties. The front office placed investments and foreign exchange transactions. The back office reviewed all trading transactions to ensure compliance with guidelines and independently confirmed transactions with counterparties’ back offices. The back office personnel also monitored limit compliance and reporting. Back office personnel reported directly to the Comptroller or Deputy Director of Finance in the event of excess in counterparty limits, overdraft on Treasury bank accounts, dealing with unauthorized counterparties and dealers confirming their own trade.

Risk assessment policies and procedures were in place to identify foreign exchange risks, investment asset class risks, credit risks, interest rate risk and cash flow risks. Guidelines and policies had been documented in the UNICEF Financial and Administrative Policy 9: Treasury and Investment Management to mitigate financial risks, and procedures were in place to monitor compliance with the control measures implemented.

Relationship agreements
Written relationship agreements between UNICEF and its counterparties clearly indicated personnel authorized to engage in transactions with the counterparty, and included appropriate references to UN immunities and privileges and UNCITRAL Arbitration Rules.

Written relationship agreements did not require counterparty acknowledgement. It was presumed that there was implicit agreement if the counterparty engaged in trading activities with UNICEF. DFAM stated that the counterparties might be unwilling to sign relationship agreements. However, in case of disputes, counterparties could deny the existence of explicit agreements with UNICEF. DFAM indicated that the risk of the lack of counterparty acknowledgements was mitigated through trade confirmations.

**Agreed action 9 (medium priority):** The Division of Financial and Administrative Management agrees to reconfirm with the Legal Advisor that the lack of counterparty acknowledgements is mitigated through trade confirmations and will, as appropriate, update the text of the relationship letters with Treasury counterparties. DFAM also agrees to poll other UN agencies on their practices.
Responsible staff: Senior Financial Management Specialist.
Date by which action will be completed: March 2014.
5 Sufficiency of liquidity to meet operations requirements

The audit determined whether fund balances were managed to earn a competitive market rate of return while providing sufficient liquidity to meet global operating cash requirements.

Cash flow forecasts

Liquidity requirements are defined in the *Treasury Cash & Investment Management Guidelines and Procedures*. The current guideline for liquidity has been established as the year-end convertible Regular Resource (RR)\(^6\) cash balances to be a minimum of 10 percent of the following year’s Medium Term Strategic Plan (MTSP) forecast of RR income. In UNICEF’s Medium-Term Strategic Plan (MTSP), the RR forecast income for 2012 was US$ 1.049 billion, requiring liquidity reserves of US$ 104.9 million for 2011. The MTSP forecast income for 2013 is US$ 1.069 billion, requiring liquidity reserves of US$ 106.9 million for 2012.

The FAC established and periodically reviewed the liquidity guideline. It also monitored actual liquidity on a regular basis. Cash balances were monitored daily to maintain sufficient liquidity to meet cash requirements.

Liquidity requirements were managed, in part, based on cash flow forecasts that were developed monthly by Treasury Management. There was a significant variance between monthly forecasts and actual cash flows. The monthly variance between actual and forecast for 2011-2012 ranged from negative 24.65 percent to positive 26.21 percent, with an annual average variance for 2011 of positive 4.6 percent and for 2012 of negative 5.9 percent. Anticipating actual operating cash requirements was not possible, given the imprecision of available cash forecasting data and tools.

In response to inexact cash forecasting, Treasury Management holds cash reserves in excess of the established minimum requirements as a cushion for immediate, unexpected disbursement requirements. It has set an informal liquidity level of US$ 270 million to cover unanticipated contingencies. Actual liquidity during the audit period exceeded both the established minimum requirement and the surplus cash reserves held in overnight investments to cover the wide variance between forecast and actual cash flows. The result was that while liquidity needs were met, surplus cash reserves were not invested as they otherwise would have been. An improvement in the forecast would allow an increase in the portion of the portfolio held in longer maturity investments, resulting in a greater return on these assets.

Establishing the daily cash position, i.e., daily cash forecasting, requires a great deal of data rekeying from multiple sources, including SAP, emailed reports of daily disbursements, and other Excel spreadsheets. Errors and omissions may result in bank overdrafts and over-

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\(^{6}\) Regular Resources are core resources that are not earmarked for a specific purpose, and can be used by UNICEF wherever they are needed. They include income from voluntary annual contributions from governments, un-earmarked funds contributed by National Committees and the public, and net income from greeting-card sales. Other Resources are contributions that have been made for a specific purpose such as a particular programme, strategic priority or emergency response, and may not be used for other purposes without the donor’s agreement.
investments. Under-reported disbursements created seven overdraft situations during the audit period.

The above happened because of difficulty in predicting the timing and amount of contributions. The SAP integrated forecasting module does provide the technology to analyse historic patterns, report scheduled expenditures and permit forecasting using expected value estimates, scenario analysis and simulation. However, it had not been implemented. Daily cash position reporting errors typically result from omissions of disbursements from the Excel spreadsheet used to report daily cash balances. Rekeying data is subject to input errors, and Excel applications may contain formula errors that go undetected for extended periods.

**Agreed action 10 (medium priority):** The Division of Financial and Administrative Management agrees to implement the following SAP modules:

1. The SAP cash forecasting module, enabling improvement in forecasting accuracy, which would provide for a reduction in the current level of liquidity reserves. As SAP is a global application, the SAP forecast module could improve the accuracy of the global cash forecast by providing the Public Sector Alliances and Resource Mobilization Office and Private Fundraising and Partnerships with the technology to monitor and refine their forecasts.

2. The SAP cash management module. This module automatically produces a daily cash position report that includes all scheduled disbursements and investment maturities, and imports electronic bank report transactions. This technology would eliminate keying errors and omissions, and possible overdrafts as a result of unreported disbursements.

Responsible staff: Senior Financial Management Specialist.
Date by which action will be completed: March 2014.
6 Optimization of investment portfolio returns

The audit determined whether portfolio returns were commensurate with risk tolerance and market returns.

Satisfactory key controls
UNICEF outperformed its 2011 benchmark by 28 basis points and its 2012 benchmark by 12 basis points. The investment performance contributed US$ 28.8 million in 2012 and US$ 27.2 million in 2011 to UNICEF revenues. Investment guidelines are conservative and consistent with preservation of capital. Investment guidelines address counterparty risk, market risk, interest rate risk, liquidity risk and credit risk. Compliance with these guidelines is monitored and reported to management and the FAC on a regular basis.

The benchmarks UNICEF has selected for investment portfolio performance were appropriate when compared with Treasury best practices. LIBOR (London Interbank Offered Rate) is a good benchmark for short-term, money market fixed income investments. Matching the term of the investment to the benchmark was appropriate. For the longer-term fixed income, the duration of the portfolio was appropriately matched to the rate of treasury instruments of a similar duration.

UNICEF continuously monitored counterparty risk, using financial, economic and political information, and maintained an internal watch list of countries and counterparties. These steps were taken to restrict the size limits and tenor of deposits and investments with counterparties located in volatile and difficult economic markets. The size limits defined in the minutes of each FAC meeting were found to be appropriate, even given the changing risk landscape globally. For example, given the European economic environment, investments in PIIGS counterparties (Portugal, Italy, Ireland, Greece and Spain) were restricted to a maximum of 30 days — and DFAM has subsequently informed the audit that investment in PIIGS has been discontinued.

UNICEF maintained major trading and investment relationships with approximately 40 financial institutions in order to avoid excessive concentration in any one institution, while at the same time maintaining the number of financial relationships at a manageable level.

Cash flow investments
Improvements in cash flow forecasting (see observation on Cash flow forecasts, above) would result in increased investment income by permitting funds to be placed in higher yielding time deposits and fixed-income investments. The audit noted that asset allocation within the portfolio was heavily concentrated in time deposits. Although UNICEF’s investment policy permits up to 50 percent of the portfolio to be held in fixed-income securities (such as treasury and federal agency issues, and sovereign and supranational debt), fixed-income securities comprised approximately 6 to 18 percent of portfolio holdings during the audit period. As a rule, fixed-income securities typically outperform time deposits.

The significant variance between monthly cash flow forecasts and actual activity required that surplus cash reserves be held in overnight investments to cover unexpected contingencies, resulting in actual liquidity in excess of the established minimum
requirement. During the second quarter of 2012, a bank froze UNICEF’s securities custodial account as a result of a dispute over a custody agreement. As a result, fixed-income investments were curtailed until a new custodial partnership could be established in January 2013.

**Agreed action 11 (medium priority):** The Division of Financial and Administrative Management agrees to consider repositioning the investment portfolio to increase the asset allocation in fixed-income securities to the extent that the rates of return exceed those offered on time deposits. Also, DFAM’s implementation of the SAP cash forecasting module (see agreed action 10, above) will lead to improvement in forecasting accuracy and allow for a reduction in the current level of liquidity reserves.

Responsible staff: Senior Financial Management Specialist.
Date by which action will be completed: Ongoing on the securities investment side; for the SAP functionality, March 2014.
7 Compliance with regulations, guidelines and rules

The audit established whether investment purchases and foreign currency transactions were executed in accordance with Treasury Cash & Investment Management Guidelines and Procedures.

Satisfactory key controls
Treasury Cash & Investment Management Guidelines and Procedures define investment policies and procedures in the following areas:

- acceptable counterparties and credit ratings guidelines;
- investment limits;
- permitted investment assets;
- separation of trading authority and confirmation activity;
- competitive bidding;
- asset allocation; and,
- investment horizon.

Testing was performed to confirm compliance with these policies for investment and foreign currency transactions and there were no exceptions noted on compliance with these policies.

Treasury position and limits compliance reports
Treasury Position and Limits Compliance Reports are not prepared on a regular basis and selected risk mitigation controls are not regularly monitored. This occurred because of a lack of technological resources and automated reporting capabilities, which created human resource incapacity to efficiently assess and monitor risks. Delayed and infrequent reporting due to the complex manual calculations and data manipulation necessary to produce accurate compliance reporting further weakened risk control activities. (See related risk discussed in the assessment and management of risk).

Agreed action 12 (medium priority): DFAM should:

i. assess and ensure that technological and staffing resources to monitor established risk control policies and guidelines are employed;
ii. request for the prioritisation of SAP configuration and reporting requirements for Treasury management; and,
iii. assess SAP technology expertise requirements.

Responsible staff: Senior Financial Management Specialist.
Date by which action will be completed: March 2014.
8 Reporting treasury performance against benchmark

The audit determined whether the investment performance reports were accurate and the methodology for computation of return on investments (ROI) was consistent with industry standards.

Return on investment (ROI)
The investment performance reports were accurate and consistent with industry standard. However the ROI computation was performed manually in an Excel application, which was subject to keying errors and undetected formula corruption and miscalculations. This occurred because the SAP Portfolio Analyzer module had not been implemented and SAP did not support the production of ROI reports.

Agreed action 13 (medium priority): DFAM agrees to ensure that the SAP Portfolio Analyzer is implemented to produce robust investment portfolio performance metrics.

Responsible staff: Senior Financial Management Specialist.
Date by which action will be completed: March 2014
Annex A: Methodology, and definition of priorities and conclusions

The audit team used a combination of methods, including interviews, document reviews, testing samples of transactions. The audit compared actual controls, governance and risk management practices found in the office against UNICEF policies, procedures and contractual arrangements.

OIAI is firmly committed to working with auditees and helping them to strengthen their internal controls, governance and risk management practices in the way that is most practical for them. The heads of offices audited and their staff work with the audit team on agreed action plans to address the observations. These plans are presented in the report together with the observations they address. OIAI follows up on these actions, and reports quarterly to management on the extent to which they have been implemented. When appropriate, OIAI may agree an action with, or address a recommendation to, an office other than the auditee’s (for example, a regional office or HQ division).

The audit looks for areas where internal controls can be strengthened to reduce exposure to fraud or irregularities. It is not looking for fraud itself. This is consistent with normal practices. However, UNICEF’s auditors will consider any suspected fraud or mismanagement reported before or during an audit, and will ensure that the relevant bodies are informed. This may include asking the Investigations section to take action if appropriate.

The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors. OIAI also followed the reporting standards of International Organization of Supreme Audit Institutions.

Priorities attached to agreed actions

**High:** Action is considered imperative to ensure that the audited entity is not exposed to high risks. Failure to take action could result in major consequences and issues.

**Medium:** Action is considered necessary to avoid exposure to significant risks. Failure to take action could result in significant consequences.

**Low:** Action is considered desirable and should result in enhanced control or better value for money. Low-priority actions, if any, are agreed with the country-office management but are not included in the final report.

Conclusions

The conclusions presented at the end of each audit area fall into four categories:

*Unqualified (satisfactory) conclusion*

Based on the audit work performed, OIAI concluded at the end of the audit that the control processes over the country office [or audit area] were generally established and functioning
during the period under audit.

**[Qualified conclusion, moderate]**
Based on the audit work performed, OIAI concluded at the end of the audit that, subject to implementation of the agreed actions described, the controls and processes over [audit area], as defined above, were generally established and functioning during the period under audit.

**[Qualified conclusion, strong]**
Based on the audit work performed, OIA concluded that the controls and processes over [audit area], as defined above, needed improvement to be adequately established and functioning.

**[Adverse conclusion]**
Based on the audit work performed, OIA concluded that the controls and processes over [audit area], as defined above, needed significant improvement to be adequately established and functioning.

**[Note: the wording for a strongly qualified conclusion is the same as for an adverse conclusion but omits the word “significant”.]**

The audit team would normally issue an unqualified conclusion for an office/audit area only where none of the agreed actions have been accorded high priority. The auditor may, in exceptional circumstances, issue an unqualified conclusion despite a high-priority action. This might occur if, for example, a control was weakened during a natural disaster or other emergency, and where the office was aware the issue and was addressing it. Normally, however, where one or more high-priority actions had been agreed, a qualified conclusion will be issued for the audit area.

An adverse conclusion would be issued where high priority had been accorded to a significant number of the actions agreed. What constitutes “significant” is for the auditor to judge. It may be that there are a large number of high priorities, but that they are concentrated in a particular type of activity, and that controls over other activities in the audit area were generally satisfactory. In that case, the auditor may feel that an adverse conclusion is not justified.