unicef for every child

Office of Internal Audit and Investigations

Internal Audit of the

FINANCING OF FUNDRAISING ACTIVITIES – WORLD BANK BOND

JUNE 2023

Report 2023/10

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EXECUTIVE SUMMARY

The Office of Internal Audit and Investigations (OIAI) conducted an audit of UNICEF's financing of private sector fundraising (PSFR) activities with a focus on the US$50 million World Bank Bond, which marked the very first time UNICEF implemented a loan-type financing mechanism. The audit covered the period from January 2021 to October 2022. It was conducted from August to October 2022 in conformance with the International Standards for the Professional Practice of Internal Auditing. The overarching objective of the audit was to assess the adequacy and effectiveness of control processes over the allocation of the Bond proceeds for investment and monitoring and reporting in respect of the investment of those proceeds.

Overall Conclusion

Based on the audit work performed, OIAI concluded that the assessed governance, risk management and control processes were **Partially Satisfactory, Improvement Needed**, meaning that the weaknesses or deficiencies identified were unlikely to have a materially negative impact on the performance of the audited entity, area, activity or process. (See the Appendix for definitions of the conclusion ratings.)

	Satisfactory
	Partially Satisfactory, Improvement Needed
	Partially Satisfactory, Major Improvement Needed
	Unsatisfactory

Summary of Observations and Recommended Actions

OIAI noted several areas where UNICEF's controls were adequate and functioned well. For example, UNICEF had appropriately modified its governance and financial management system for the allocation, investment, accounting and reporting related to the funds received from the World Bank. Appropriate internal governance structures and processes were established. There was a transparent process, based on defined criteria, for the selection of country offices to receive investment funds from the World Bank financing. The financial management information system allows tracking of investments from proceeds of the Bond to country offices and channels, cumulative individual donations raised, and donors acquired, and cumulative individual donations raised in the emerging-market countries.

The audit also made a number of observations related to the management of the key risks evaluated. In particular, OIAI noted:

- **Allocation of Bond proceeds for investment**: Delays were noted in the disbursement of funds from the World Bank Bond. The idle/uninvested funds may have led to an overall reduction of earnings from the borrowed funds, while the interest payments were due. These delays may have reduced the potential generation of income from the World Bank Bond.

- **Monitoring and reporting**: Other than the Bond's proceeds, UNICEF invested US$89 million of its own funds in PSFR activities during the period audited. The returns on investment were monitored for the pooled investments of both the borrowed Bond and UNICEF's own funds. Therefore, the impact of the Bond's financing on the investment returns could not be separately established, and there was a risk of inaccurate reporting on the impact of the borrowed funds.

The table below summarizes the key actions management should take to address the residual risks identified and the ratings of these risks and observations in respect of the assessed governance, risk management and control processes. (See the definitions of the observation ratings in the Appendix.)

OBSERVATION RATING		
Category of Process	**Area or Operation and Recommended Action**	**Rating**
Governance	**Allocation of Bond proceeds for investment (Observation 1)**: When borrowing funds from any source external to UNICEF or requesting an increase in investment funds, ensure that the amount of the loan or request is based on the absorptive capacity of the organization and that relevant systems are modified as needed.	Medium
Control processes	**Monitoring and reporting (Observation 2)**: Improve the reporting on the World Bank Bond in reports to the Executive Board by disclosing the implications of delays in investing the proceeds and providing additional information such as the cumulative number of pledge donors and changes in such numbers, as well as segregating investments by funding source.	Medium

Management is responsible for establishing and maintaining appropriate governance, risk management and control processes and implementing the actions agreed following this audit. The role of OIAI is to provide an independent assessment of those governance, risk management and control processes.

CONTEXT

UNICEF raises a substantial percentage of its private sector income from emerging markets in Asia, Europe and Latin America. Most of this income is composed of monthly pledge instalments from individual donors. The long-term growth of private sector income in these markets depends on the level of investments made to acquire new donors, replace lapsed donors and increase the overall pool of donors generating monthly income.

The onset of the pandemic in 2020 and its related economic, social and public health impacts profoundly transformed the global landscape and brought significant challenges and risks to UNICEF's fundraising. Based on a projected decline in regular resources and the consequent reduction in investment funds available to country offices, UNICEF looked for ways to finance these investments with the overall objective of increasing its future donation cash flows. Given the historical data and experience regarding the overall dependability, stability, and resilience of various income streams, management opted to prioritize and secure sufficient funding for initiatives pertaining to the acquisition and retention of monthly pledge donors. In 2020 and 2021, UNICEF and the World Bank developed a pilot financial instrument to facilitate investment in PSFR countries to help UNICEF finance its activities.

The Executive Board, during its first regular session, held from 9 to 12 February 2021, authorized UNICEF to execute the financing instrument as a pilot project in partnership with the World Bank to raise additional financing for investment in PSFR. On 25 February 2021, UNICEF and the World Bank concluded a forward flow agreement, in which it was determined that the loan to UNICEF would be US$50 million less the aggregate amount of any costs and expenses agreed by the parties to be payable by UNICEF. In March 2021, UNICEF received the US$50 million for investment in PSFR activities, which, together with existing and new monthly pledge donors in emerging markets, would yield US$450 million over the five-year maturity period. This assumption was derived from historical calculations and trend analysis, examining the overall return on investment across various fundraising channels. The funds are typically allocated across diverse fundraising channels, including face-to-face or door-to-door approaches, telemarketing, direct response television, and digital platforms, with the ultimate goal to expand the base of regular monthly pledge donors.

UNICEF agreed to repay the US$50 million with the overall income from pledge donors in emerging markets. It will also repay the interest coupons and principal from gross income as first or senior payment before other costs. Of the US$50 million UNICEF received in March 2021, the costs related to the World Bank instrument totaled US$589,750, comprising underwriting costs of US$62,500, World Bank administrative expenses of US$50,000, and a first interest instalment payment of US$477,250 that was made to the World Bank in August 2021. The interest payment was triggered by a condition related to the amount of UNICEF cumulative donations from the target emerging-market countries, which had exceeded US$50 million in the period from March to June 2021.

The United Nations Board of Auditors carried out a review of this Bond and noted that it had not been expressly authorized under the UNICEF Financial Regulations and Rules. The board acknowledges the innovative approaches that UNICEF has taken to raise additional funds to enable it to fulfil its mandate. However, it concluded that such new approaches should always be carried out in strict compliance with regulations to avoid exposing the organization to financial risks. On the board's recommendation, UNICEF therefore agreed to obtain specific authority from the General Assembly in the event of borrowing funds from any source external to the organization to ensure strict compliance with regulations when using financing instruments for fundraising that may create a financial liability.

AUDIT OBJECTIVES, SCOPE AND APPROACH

The objective of the audit was to assess the adequacy and effectiveness of the governance, risk management and control processes over a selection of significant areas related to the management of the World Bank Bond. The audit scope included key areas, set out in the following table, that were selected during the audit planning process based on an assessment of inherent risks.[1]

The scope of the audit included the design of the governance structure and risk management processes put in place to manage the World Bank Bond, the procedures related to the selection of country offices and the disbursement of funds, and the design of the monitoring and reporting processes put in place as of October 2022. The audit did not assess the legality of the World Bank instrument, as this was covered separately in the United Nations Board of Auditors' report.

RISK AREA	KEY INHERENT RISKS EVALUATED DURING THE AUDIT
Governance and capacity	Inadequate governance and capacity may result in poor decisions around the allocation and investment of the proceeds from the Bond that would diminish achievement of the goal of the Bond and lead to financial loss.
Monitoring and reporting	The lack of appropriate systems may result in delays and inaccurate reporting, which may, in turn, reduce UNICEF's ability to promptly identify problems and take corrective actions.

The audit was conducted from August to October 2022 in accordance with the International Standards for the Professional Practice of Internal Auditing. For the purpose of audit testing, the audit covered the period from January 2021 to October 2022. It involved a combination of methods, tools and techniques, including interviews, data analytics and document reviews.

[1] Inherent risk refers to the potential adverse event that could occur if management takes no actions, including internal control activities. The higher the likelihood of the event occurring and the more serious the impact would be should the adverse event occur, the stronger the need for adequate and effective risk management and control processes.

The key areas where actions are needed are summarized below.

1. Allocation of Bond proceeds for investment — Medium

OIAI noted that the US$50 million in proceeds from the Bond was made available to country offices for investment several months after the proceeds were received by UNICEF. The first tranche of US$15 million was distributed to country offices in June 2021, approximately three months after the proceeds were received, and the second and final tranche of US$35 million was distributed to the offices in December 2021, approximately nine months after the proceeds were received.

The Division of Financial and Administrative Management (DFAM) stated that by the time all proceeds were provided to country offices, approximately US$954,500 in interest had already accrued and had been paid from a special-purpose budget. DFAM stated that it invested the proceeds before allocations were made to country offices, and revenue from this investment in 2021 and 2022 was approximately US$313,900. Due to the lack of relevant data, OIAI was unable to determine whether the revenue generated prior to allocation compared favorably to the revenue that would have been generated had the proceeds been allocated to country offices earlier.

There were several reasons for the delays in providing the funds to country offices:

- This was the first instrument of this type used by a United Nations entity, and UNICEF had not completed modifying its governance and financial management systems when the proceeds were received.

- Based on the assessment of the absorptive capacity of target country offices, UNICEF needed and therefore allocated only US$15 million 2021. The rest of the proceeds were to be allocated only when country offices were ready to invest. OIAI was informed that the smallest amount that the Word Bank was initially willing to provide was US$100 million. Apparently, this exceeded the absorptive capacity of the targeted country offices. Therefore, following negotiations, the amount reduced to US$ 50 million. While acknowledging the need to avoid idling of investment funds in country offices, OIAI is of the view that establishing the absorptive capacity of offices after the Bond proceeds were received created a risk of allocating investment funds to some country offices beyond their absorptive capacities.

UNICEF informed OIAI that it plans to conduct a review of the current Bond and present a report to the Executive Board for consideration during the June 2023 session. The outcome of the review will inform the board’s decision as to the next step, including whether to give UNICEF permission to request specific authorization from the United Nations General Assembly to borrow from external sources. This decision will depend on investment needs, available internal resources, and UNICEF obtaining permission to borrow from capital markets.

RECOMMENDED ACTION

When borrowing funds from any source external to the organization or requesting an increase in investment funds, UNICEF should ensure that the amount of the loan or request is based on an adequate evaluation of the needs and absorptive capacity of the organization and that relevant systems are modified as needed.

2. Monitoring and reporting — Medium

In its decision 20121/5, the Executive Board requested that UNICEF report to the Board annually on the financial instrument with the World Bank, specifically the financial performance and the attainment of goals and corresponding costs and capacities. UNICEF stated that it has fully met all its reporting obligations with the Executive Board. Indeed, as required, UNICEF had provided four updates to the Board on separate occasions, including an initial update at the annual session in 2021, one at the first regular session of 2022, another at the annual session in 2022, and the latest update, UNICEF/2023/EB/5, dated 20 December 2022 and presented at the first regular session in 2023. UNICEF also provided an impact report on the use of the funds to the World Bank and its financial investors in May 2022.

Related costs: According to the latest update to the Executive Board, 2022 payments related to the World Bank instrument totaled US$954,500. These were mainly interest costs paid to the World Bank and brought the total World Bank instrument-related costs from its inception (February 2021) to September 2022 to US$1.5 million. As discussed in the previous observation, UNICEF stated that prior to allocating the proceeds to country offices, it invested them, realizing a revenue of approximately US$313,900 in respect of the investment in 2021 and 2022. In OIAI's view, such revenue associated with the Bond should be disclosed when reporting related costs to the board.

Attainment of goals: The goal for the financing was to grow individual pledge donors through the allocation of funds across diverse fundraising channels, such face-to-face or door-to-door approaches, telemarketing, direct response television, and digital platforms, by each of the targeted country offices. However, UNICEF had not reported on the attainment of this primary goal of the instrument. Instead, UNICEF reported in its latest update to the Executive Board that, as of September 2022, the cumulative pledge donations from the 24 countries using funding from the World Bank instrument had reached US$179 million. UNICEF attributed these results to the pooled investment comprising US$50 million from the World Bank instrument and US$89 million of its own resources. While reporting on cumulative donations is welcomed and encouraged, it provides inadequate visibility with respect to changes in the number of pledge donors, which should be a measure of growth. In this regard, OIAI noted that a significant majority of the donations reported came from donors that had been acquired before UNICEF invested the proceeds from the instrument. This suggests that it is still too early for the intended impact of the instrument to be measured.

UNICEF stated that the investment was also meant to retain existing pledge donors and minimize attrition. Changes in donor retention rates attributed to the investment could also be disclosed in reporting to the board.

Capacities: UNICEF has a financial management information system for monitoring and attributing the revenue generated from investing its own resources in various investment channels (pledge donors, one-time donors, institutional donors) in each country office. For each country with an investment portfolio, fundraising and financial key performance indicators are periodically monitored for all channels of investment. OIAI noted that UNICEF had appropriately modified the system to allow for reporting on the allocation and utilization of the funds received from the World Bank, as well as the cumulative revenue generated from the pooled investment meant to grow pledge donors in countries that received funding from the World Bank Bond. While acknowledging that the system is not designed to, and therefore cannot facilitate, attribution of revenue to specific sources of investment funds, OIAI noted that the financial management information system contains information on the cumulative number of pledge donors in each market where the proceeds from the Bond have been invested. This information is particularly relevant to reporting on the overall objective of the instrument: to grow individual pledge donors.

RECOMMENDED ACTION

To enhance the usefulness of its reporting, UNICEF should:

i. Disclose the implications of delays in investing the proceeds of the World Bank Bond in its report to the Executive Board.

ii. Identify and disclose additional information such as the cumulative number of pledge donors and changes in such numbers as well as segregating investments made by funding source.

iii. Ensure that the reports presented to the Board include a comparison of the actual funds raised and the associated financing costs.

APPENDIX

Definitions of Audit Observation Ratings

To assist management in prioritizing the actions arising from the audit, OIAI ascribes a rating to each audit observation based on the potential consequence or residual risks to the audited entity, area, activity, or process, or to UNICEF as a whole. Individual observations are rated as follows:

Low	The observation concerns a potential opportunity for improvement in the assessed governance, risk management or control processes. Low-priority observations are reported to management during the audit but are not included in the audit report. Action in response to the observation is desirable.
Medium	The observation relates to a weakness or deficiency in the assessed governance, risk management or control processes that requires resolution within a reasonable period of time to avoid adverse consequences for the audited entity, area, activity, or process.
High	The observation concerns a fundamental weakness or deficiency in the assessed governance, risk management or control processes that requires prompt/immediate resolution to avoid severe/major adverse consequences for the audited entity, area, activity, or process, or for UNICEF as a whole.

Definitions of Overall Audit Conclusions

The above ratings of audit observations are then used to support an overall audit conclusion for the area under review, as follows:

Satisfactory	→	The assessed governance, risk management or control processes were adequate and functioning well.
Partially Satisfactory, Improvement Needed	→	The assessed governance, risk management or control processes were generally adequate and functioning but needed improvement. The weaknesses or deficiencies identified were unlikely to have a materially negative impact on the performance of the audited entity, area, activity, or process.
Partially Satisfactory, Major Improvement Needed	→	The assessed governance, risk management or control processes needed major improvement. The weaknesses or deficiencies identified could have a materially negative impact on the performance of the audited entity, area, activity, or process.
Unsatisfactory	→	The assessed governance, risk management or control processes were not adequately established or not functioning well. The weaknesses or deficiencies identified could have a severely negative impact on the performance of the audited entity, area, activity, or process.

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