

Internal Audit of the Harmonized Approach to Cash Transfers (HACT) at UNICEF

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Audit objectives and scope

The objective of the audit was to determine whether HACT was an adequate and effective mechanism for managing key risks to the intended use of cash transferred to and delivery of results agreed with implementing partners across country offices.

The audit was conducted from April 2019 to May 2020. It covered the period from January 2017 to October 2019 and focused on HACT-related activities implemented at headquarters and in all seven regional offices. Specific audit procedures were performed in at least one country office in each region including: Madagascar, Afghanistan, Philippines, Democratic Republic of Congo, Uzbekistan, Brazil, Syria and Jordan. Specifically, the audit focus on the following:

- Governance and oversight.
- Tools and systems.
- Impact and cost of HACT.
- Macro- and micro assessments.
- Planning and execution of assurance activities.

The present report is also informed by those results as well as the relevant results of our audits of country offices in the past few years.

Summary

Background and context

The HACT framework was first adopted in 2005 by UNDP, UNICEF, UNFPA and WFP,¹ following United Nations General Assembly Resolution 56/201. The resolution reaffirmed that national Governments have primary responsibility for their countries' development and called for UN organizations to support Governments' efforts in this direction. It is built on the principle that Government and non-governmental organization (NGO) partners are ultimately responsible for their own financial management. A high-level objective of the HACT framework is to support close alignment of development aid with national priorities and to strengthen national capacities for management and accountability.

Prior to HACT, UNICEF obtained assurance over the use of cash transferred to partners by reviewing all supporting documents for expenditure reported by partners. HACT is meant to replace this to ensure the risk is considered in working with partners. The HACT is a mechanism used by UNICEF² for transferring cash to implementing partners and other third parties and for managing the risks to the cash transferred. It also used to manage the risk to the effective delivery of results agreed with the partners. It involves assessing the risk of working with particular partners by assessing the partner's financial management system and capacity. This assessment is then used to determine the least risky way to transfer cash to the partner, as well as the type and frequency of assurance activities including spot checks, programme monitoring, audits to commission and/or conduct, to ensure the residual risks of working with the partner are properly managed.

¹ It has since been decided that, as WFP primarily distributes goods rather than cash, it need not use the HACT framework. The framework was revised in 2014.

² The United Development Programme (UNDP) and the United Nations Population Fund (UNFPA) also use of HACT, albeit differently in working with their implementing partners.

The Division of Financial and Administrative Management (DFAM) is responsible for the overall management and administration of UNICEF financial resources, and the Data, Analytics, Planning and Monitoring division (DAPM)³ is responsible for promulgating the policy and guidance used by regional and country offices in implementing, overseeing, and monitoring HACT-related activities. The Global Shared Services Centre (GSSC) in Budapest is responsible for processing and making payments to implementing partners and vendors that country offices work with.

In 2014-15, drawing on experience from the first decade of implementation, UNICEF developed a strategy to strengthen the management of HACT at all organization levels. To implement this strategy, UNICEF committed a total of US\$ 20 million to a HACT Investment Fund. It also created HACT specialist positions and/or HACT focal points in the regional and country offices.

In 2018, UNICEF worked with more than 9,000 implementing partners, channelling more than US\$ 2 billion, about 30 percent of UNICEF's total expenditure, through them. Approximately 60 percent of this went to Government partners and 40 percent to NGOs.

The risks associated with HACT

In 2018, UNICEF country offices with more than 9,000 implementing partners, channelling more than US\$ 2 billion, about 30 percent of UNICEF's total expenditure, through them. As part of its 2019 planning process, OIAI assessed as significant the risk that HACT may not be an adequate and effective mechanism for managing significant risks to the intended use of cash transferred to and effective delivery of results by implementing partners across country offices. For example, the risks may materialize if partners are not properly assessed and appropriately monitored under the HACT framework. OIAI also assessed as significant the possibility that the relevant control environment may poor, reducing the effectiveness of HACT.

Results of the audit and actions agreed

The audit made some positive observations. In 2014, UNICEF rolled out its HACT strategy with the goal of strengthening management, governance and oversight of HACT at all levels within UNICEF. It allocated US\$ 20 million to implement the strategy, and significant work had been done since. Notably, eTools,⁴ a digital partnership management system, had been introduced, and structures and capacities had been created at headquarters, regional and country office levels. However, OIAI noted that the management of HACT-related would be further improved by strengthening systems at Headquarters and regional offices. The audit noted the following.

- i. Although accountability for financial management rested with DFAM, there was inadequate evidence that it was involved in promulgating policy and guidance for, and oversight of, HACT. Therefore, DFAM was not always able to promptly identify and ensure appropriate actions were taken when needed to improve risk-management practices and internal controls related to cash transfers. There was thus a high residual risk of inconsistency in the quality of HACT activities across country offices.
- ii. Further, OIAI noted that UNICEF had relied significantly on individual country offices that appeared to either lack relevant skills or were potentially conflicted to be objective in conducting and managing HACT and overseeing HACT assurance activities. This was in

³ Prior to July 2019 the office responsible was the Field Results Group (FRG), but this is now part of DAPM.

⁴ See observation *HACT-related automation and digitization*.

line with UNICEF's decentralized approach to delivering results for children which, in OIAI view, requires reassessment in the case of HACT. While some incompatible responsibilities for various aspects of HACT appeared to be segregated in country offices, OIAI is of the view that a poor control environment in a country office would render HACT ineffective in mitigating significant risks. Yet, DFAM and regional offices were too removed from HACT assurance activities.

- iii. In measuring the achievement of HACT objectives, UNICEF had focused almost entirely on the completion of assurance activities against minimum compliance requirements. OIAI found no clear evidence that UNICEF was also assessing contribution of HACT to the effective management of partnerships or mitigation of the risks of working with them. The fact that the HACT policy itself does not explicitly include a requirement to monitor and report on the qualitative aspect of HACT underscores this shortcoming. There was therefore inadequate assurance that HACT could be relied upon as the sole mechanism for ensuring funds provided to partners were used as intended.
- iv. UNICEF no longer requires a macro-assessment of potential partners. Its view after some years' experience was that the macro-assessments did not improve the risk culture as they were done primarily for compliance purposes and micro-assessments were more effective in assessing the risks of working with partners. OIAI concurs with this view. However, it also noted that offices did not always conduct micro-assessments of those partners that met the established threshold and assumed high risks in the absence of micro-assessments. UNICEF allows this; however, the exceptional circumstances under which high risks may be assumed were not clearly set out and was therefore subject to abuse.
- v. UNICEF expects offices to implement assurance activities after funds have been exposed to heightened risk of fraud and irregularities. However, OIAI noted that the risk ratings of partners as determined by micro-assessments (or assumed high risk where they had not been done) were not always used in planning and scheduling programmatic visits and audits of partners.

As a result of the audit, and in discussion with the audit team, DAPM and DFAM have agreed to take a number of measures. These include one action that is rated as high priority – that is, requiring immediate management attention. This was that DAPM and DFAM, under the overall leadership of the Deputy Executive Directors for Management and Programmes of UNICEF and in collaboration with regional directors would review and, as necessary, redefine the roles, responsibilities, and accountabilities for governance and oversight of HACT, the conduct of spot checks and management of assurance services contracts. The goal would be to increase DFAM's HACT-related role and responsibility and accountability in governance and oversight; and strengthen regional offices' HACT-related capacities so that they become centres of expertise for HACT financial assurance activities including spot checks, management and oversight of assurance services.

Conclusion

Based on the audit work performed, OIAI concluded that, subject to implementation of the agreed actions described below, the controls and processes governing the implementation of HACT across UNICEF were generally established and functioning during the period under audit.

Audit observations

Governance and oversight

In 2014, UNICEF rolled out its HACT strategy with the goal of strengthening management, governance and oversight of HACT at all levels within UNICEF. UNICEF had allocated US\$ 20 million for 2014-2017 to implement the strategy. The three broad objectives were: effective capacity at all levels (from headquarters to country office) for management of HACT; efficient systems for planning, monitoring and reporting; and effective leadership.

Significant work has been done since the strategy was rolled out. Notably, eTools has been rolled out; this is a digital partnership management system, with a module for management of HACT-related activities, and is on track to be functional across all country offices (it is discussed further in the following observation). Structures and capacities have been created at headquarters, regional and country office levels; and several procedures and guidelines have been issued to help offices implement HACT effectively and efficiently.

However, the audit noted the following.

Headquarters governance and oversight of HACT: There is split accountability for HACT. The UNICEF policy on cash transfers to implementing partners (FRG/POLICY/2015/001) acknowledges DFAM's authority and responsibility for the overall management and administration of UNICEF financial resources. Specifically, the policy acknowledges DFAM's authority and responsibility to develop financial management policy, procedures and guidance and report to executive management significant issues related to the management of cash transfers. Because it has overall accountability and responsibility for managing UNICEF financial resources, DFAM is expected to have and is therefore more likely to be adequately resourced to develop and/or significantly contribute to the development of adequate HACT-related policy and guidance and to effective governance and oversight HACT assurance activities including micro-assessment, spot checks and external audits of partners.

However, there was inadequate evidence that DFAM had been involved in promulgating HACT-related policy and guidance and overseeing application of these. In practice, DAPM was solely responsible for promulgating HACT policy and for developing and issuing related procedures and guidance used by regional and country offices to implement HACT. Responsibility for oversight over HACT were split between regional and country office while DAPM was also solely responsible for overseeing the quality assurance roles of regional offices.

Therefore, DFAM was not always able to ensure to promptly identify and ensure appropriate actions were taken when needed to improve risk-management practices including internal controls related to cash transfers. For example, DFAM and DAPM became aware of some questionable costs and potentially ineligible expenditures only after OIAI had identified them and reported the relevant country offices' failure to follow them up. There was thus a high residual risk of inconsistency in the quality of HACT activities across country offices. In OIAI's view, some of the HACT-related issues identified in audits of country offices, and in this report, might be better addressed if DFAM were to take a more active, evidence-based role in the governance and oversight of HACT.

Regional offices' role in spot-checks and audits of partners: The role of regional offices in spot checks and audits of implementing partners needed to be strengthened to increase confidence in these activities. In accordance with the HACT policy, country offices are

responsible for monitoring and conducting quality assurance related to HACT implementation. OIAI noted that audits of partners and, in some country offices, spot checks were done by third-party service providers. However, in a large number of cases, the staff of country offices have conducted spot checks themselves. This meant that the same offices that selected the implementing partners were sometimes conducting spot checks of those partners; where they were not, they were still overseeing the assurance activities carried out by third parties. This was in line with UNICEF's decentralized approach to delivering results for children which, in OIAI view, requires reassessment in the case of HACT. In offices where the control environment may be weak and segregation of responsibility for vetting and selecting partners and other incompatible functions may be inadequate, there may be a conflict of interest which, in combination with capacity issues, could undermine the effectiveness of HACT assurance activities. While some incompatible responsibilities for various aspects of HACT appeared to be segregated in country offices, OIAI is of the view that a poor control environment in a country office would render HACT ineffective in mitigating significant risks.

In accordance with the HACT policy, regional offices were responsible for overseeing the quality assurance roles of country offices related to HACT implementation, conducting support missions and peer reviews, and providing technical support and capacity-building. Regional offices were well placed to be an effective second line of defense for the many risks related to the implementation of HACT in country offices. However, the extent and nature and quality of HACT assurance activities varied significantly from one regional office to another, depending on the resources and skills available. Given the sheer volume of spot checks required by HACT, some regional offices lacked sufficient capacity to provide adequate and effective oversight of country offices and technical support needed. Of the seven regional offices, four had one dedicated HACT specialist, one office had three and two offices had four.

Country-office approach: The same can be said about country offices where OIAI found that the quality of the spot-checks and reports to vary widely depending on the number and quality of staff involved. While the detailed level of guidance around HACT reflects UNICEF's desire for consistency in achieving a quality of assurance, in OIAI's view, this is a further indication of the sheer number of HACT-related staff and differences in their skills across country offices. Achieving consistently high quality of tasks is difficult when the number of individuals performing the task is high. In such situations, organizations tend to issue detailed guidance even though these do not always assure consistently high quality – they tend to result in reduced focus on high risks and significantly to contribute to the 'compliance' culture we have seen in the application of HACT across country offices.

To conduct micro-assessments, scheduled and special audits and, in some cases, spot checks, country offices used accounting firms under global long-term arrangements (LTAs) with UNICEF. The LTAs required UNICEF to assess the performance and quality of the assurance work; hence the need for competent management of the relationship by UNICEF. Therefore, effective management of UNICEF's relationship with these firms requires technical knowledge and expertise in how professional firms operate. Some country offices did not have this expertise. Indeed, OIAI noted limited oversight of these arrangements; offices tended to rely on the firms without there being evidence of probing questions being asked to ensure compliance with the technical provisions of the LTAs.

Regarding special audits of partners, the UNICEF HACT procedures required country offices to consult OIAI on the appropriate terms of reference for the audit. However, offices seldom did so, and there was no clear evidence that they had consistently commissioned special audits when they needed to. In fact, there were no clear criteria for determining the requirement for special audits. The low number of cases referred to OIAI may indicate that offices were either avoiding doing special audits, or not adequately consulting OIAI when they did.

To help improve the quality of spot checks and management of assurance services, UNICEF could strengthen regional offices' capacities, gradually transforming them into centres of relevant expertise with greater involvement in these activities. Dedicated centres of this kind would require fewer procedures and less guidance, thriving instead on the ability of the staff to be creative and flexible in their application. With a dedicated body of well-trained staff and the resources needed, this arrangement will significantly increase the cost-effectiveness of spot checks and management assurance services.

Agreed action 1 (high priority): DAPM and DFAM agree to, under the overall leadership of the Deputy Executive Directors for Management and Programmes and in collaboration with regional directors, review and as needed redefine the roles, responsibilities, and accountabilities for governance and oversight of HACT – including the conduct of spot checks and management of assurance services contracts. The goal would be to increase DFAM's role and responsibility and accountability in governance and oversight; also to strengthen regional offices' HACT-related capacities so that they become centres of expertise for HACT financial assurance activities including spot checks, management and oversight of assurance services.

Responsible staff members: Deputy Director, Strategic Planning, Implementation, Monitoring & Reporting, DAPM; Deputy Director, Financial Reporting and Grants Management, DFAM

Target date: December 2020

2 HACT-related automation and digitization

In 2018, UNICEF provided US\$ 2.2 billion in cash assistance through various HACT-related mechanisms including: US\$ 1.8 billion (80 percent) in advances to implementing partners; US\$ 216.4 million (10 percent) in direct payments to partners' suppliers; and US\$ 211.8 million (10 percent) in reimbursements to partners. To manage and account for the funds, UNICEF mainly uses a facility called ezHACT in its Enterprise Resource Planning system, VISION, and a suite of electronic management tools, eTools.⁵

The audit noted the following.

eTools: This is a suite of tools designed by UNICEF to help offices keep track of various functions, including HACT assurance activities. The different components are currently being introduced across UNICEF offices. There are multiple modules related to the management of implementing partnerships. eTools also serves as a repository of documents on UNICEF's relationship with its partners.

The Financial Assurance Module of eTools is used for planning HACT-related assurance activities and for recording and monitoring actions resulting from these activities. As part of eTools, the reports from financial assurance activities are digitized. These include the quantitative findings and observations such as ineligible expenditures, as well as internal control findings identified against the predefined criteria.

In 2019, UNICEF mandated the adoption of the tool in 74 medium-to-large country offices accounting for over 90 percent of cash transfers, of which 68 had adopted it at the time of the audit. To realize the maximum return on the investment in eTools, however, UNICEF would

⁵ This is a suite of tools designed by UNICEF to help offices keep track of various functions, including HACT assurance activities. The different components are currently being introduced across UNICEF offices.

need to roll it out in all country offices. Further, after a reasonable period of using eTools, UNICEF would need to evaluate its benefits and consider enhancements that might contribute to greater automation and digitization of information required for partnership management. For example, the eTools design currently allows extraction and analysis of data globally or regionally, but it has not been fully utilized to provide offices with informed analysis on the tracking and monitoring of the results of the assurance activities. There is further opportunity to strengthen the mechanism for tracking and monitoring actions from spot-checks that would further expand its value as a risk-mitigation tool.

ezHACT: *ezHACT is used for financial accounting and reporting. The primary source of information for ezHACT is the FACE form.⁶ UNICEF processes some 55,000 paper FACE forms annually, which is a time-consuming process prone to errors and does not allow for detailed analysis. The form is typically received by a country office from a partner with cost estimates in respect of a request for cash, and to report the use (with itemized expenditures) of the cash transferred. Once received, the aggregate amount of the FACE is recorded in ezHACT and a scanned copy attached thereto.*

Further automation potential: Overall, based on the wealth of data in the existing systems, there remains the need for more automation and digitization, both through the existing systems and tools and, if needed, additional ones. The increase in remote work following the COVID-19 crisis makes this even more important.

There are four key documents for working with implementing partners and accounting for and reporting the use of funds provided to them. These are the programme documents (PD), programme cooperation agreement agreements (PCA), workplans and the FACE form. The PCA is the contract between UNICEF and a partner, whereas the PD contains a detailed description of the services required of a partner (non-governmental organization or civil society organization). The workplan contains a detailed description of the services required of Government partners.

As at the time of the audit, these key documents had not been integrated in any existing systems and generally remained paper-based. This exacerbates the potential for errors, fraud and the undetected misuse use of funds. An example of a current manual process is related to the FACE form. Once it is received, UNICEF staff manually enter the aggregate amount of expenditure and upload a scanned copy of the form into VISION, along with a copy of the detailed itemized expenditure. This relatively cumbersome procedure is potentially open to data-entry errors. Similarly, the PCAs, PDs, workplans and any long-term arrangements (LTAs), and contracts/purchase orders for goods and services, are not yet fully integrated in VISION.

In this context, OIAI noted, with great interest, the thinking within UNICEF around enhanced digitization and automation related to UNICEF's work with partners and to HACT. For example, OIAI was informed that there was a project on the automation of the FACE form; also that DFAM was considering the introduction of new expense categories (accounts) linked to the UNICEF chart of accounts that would be used to record payments made to, and expenditure incurred through, implementing partners. Also, DAPM told OIAI that it was planning to develop dashboards to be able to summarize, analyze and follow-up on the high-risk findings and observations as well as electronic programme documents with linkages to VISION and the

⁶ The Funding Authorization Certificate of Expenditure (FACE) form is used by the partner to request and liquidate cash transfers. It is also used by UNICEF to process the requests for and liquidation of cash transfers. The FACE forms should reflect the workplans, which set out the activities for which funds are being requested, or on which they have been spent. The FACE form was designed for use with the HACT framework.

United Nations Partnership Portal.⁷

Service providers currently record ineligible costs directly in eTools, by using pre-defined categories. However, there remains a need to automate individual transactions and itemize costs/expenditures incurred by partners.

Agreed action 2 (medium priority): DFAM and DPAM agree to, in collaboration with relevant stakeholders such as the [Information and Communication Technology](#) Division (ICTD) and regional and country offices, expand and enhance digitization and automation to further improve programmatic and financial management and oversight of HACT-related activities. Examples of these activities include the processing and liquidation of cash transfers, recording and follow-up of questioned/ineligible expenditures, processing of programme documents agreed with NGOs, workplans with Government and the programme cooperation agreements review process.

Responsible staff members: VISION Specialist, Financial Reporting and Grants Management Unit, DFAM; Chief, Partnership and HACT managers, Implementation Unit, DAPM; Senior Business Relationship Manager, ICTD (supported by regional offices Chiefs of Operations, and Chiefs of Programme Monitoring and Evaluation)

Target date: eZHACT – Q1 2021; eFACE - Q4 2021; eTools – January 2021

Agreed action 3 (medium priority): DAPM agrees to, in collaboration with relevant stakeholders such as regional and country offices, evaluate costs, benefits and challenges of using eTools and establish a plan for their full adoption by all country offices.

Responsible staff members: Chief, Partnership and HACT managers, Implementation Unit, DAPM; Senior Business Relationship Manager, ICTD (supported by regional offices Chiefs of Operations, and Chiefs of Programme Monitoring and Evaluation).

Target date: January 2021

3 Impact and cost of HACT

UNICEF and other UN agencies have advocated HACT as the key partnership risk management tool, and, as a result, there has been increasing donor interest in, and scrutiny of, how it is working. With this increasing stakeholder interest in HACT, it is important to assess whether it is fit for purpose.

OIAI noted that UNICEF currently measures achievement of its HACT policy objectives by examining: (a) the proportion of assurance activities implemented according to minimum requirements; (b) global costing of assessment and assurance activities; and (c) the percentage of shared partners for which assessments and audits are coordinated with other UN agencies that also use HACT. However, as indicated below, none of these indicators appear to clearly address the more important aspect of HACT – that is, the extent to which potential significant risks to working with partners have been managed and adequately mitigated.

Proportion of assurance activities implemented: As noted above, this does not really indicate the extent to which HACT has achieved its broader objectives – but it is a helpful measure of whether the basic procedures are being implemented.

⁷ The UN Partner Portal (UNPP) is a site through which NGOs can find potential partners in the UN system. See www.unpartnerportal.org.

UNICEF has comprehensive systems for monitoring and reporting on the quantity of assurance activities and whether each country office has achieved a predetermined minimum number. The 2018 annual report of the Field Results Group (now merged into DAPM) noted that the percentage of completed spot checks increased from 105 percent of minimum requirements in 2017 to 114 percent in 2018. It also noted the positive trend that 80 percent of all country offices achieved both programmatic and financial assurance (spot-check) requirements in 2018, compared to only 58 percent in 2017.

Global costing of assessment and assurance activities: In 2018, UNICEF commissioned an analysis of the costs and benefits of implementing HACT. However, there was inadequate contract management – and DAPM, which oversaw the analysis, told the audit that the report of the contractor was unreliable. Moreover, the report itself stated that the data used for analyses was not reliable.

Coordination with other HACT-adopting agencies: The HACT framework emphasized standardizing the way UN agencies work with partners to reduce transaction costs, while ensuring joint operationalization of HACT. UNICEF is a lead agency in the interagency HACT working groups and has so far developed harmonized terms of reference for spot checks, scheduled and special audits. In addition, HACT working groups are established at country level, and micro-assessments and results of assurance activities are shared among the agencies.

UNICEF HACT policy requires measuring the extent of country offices' coordination with other adopting agencies (UNDP and UNFPA). It did this by noting the percentage of shared partners for which micro-assessments and audits were coordinated with other HACT-using agencies. The baseline, target and sources of data were to have been set by 2016 upon full implementation of HACT by UNFPA and UNDP; however, at the time of this audit, this had not been done.

Potential for improvement: HACT is a mechanism for managing the risks of working with partners, which requires determining whether they have the capacities and internal controls to properly manage and report on funds provided to them. Assessing its impact should therefore include the extent to which significant risks to working with partners have been managed. This needs specific criteria or key performance indicators, in addition to the ones currently in place; they must measure risk mitigation and processes for collating relevant data across country offices.

There were some useful data and information available, such as the amount of questioned costs and potential ineligible expenditure, the amounts recovered, and improvements observed in partners' financial management systems, that could have been used for enhanced assessment of the impact of HACT. However, UNICEF had yet to put in place a mechanism for reviewing, at a global level, the results of the various assurance activities from country offices, so as to be able to report on the overall impact of HACT. There was no process or system for aggregating information of questioned and ineligible costs at country, regional or global level.

Agreed action 4 (medium priority): , DAPM and DFAM agree to, under the overall leadership by the Deputy Executive Directors for Management and Programmes and in collaboration with regional offices, establish a system to periodically assess and report on the impact of HACT on risk management practices and internal controls related to cash transfers to partners.

Responsible staff members: Chief and HACT Manager, Implementation Unit, DAPM; Chief, Financial Reporting, Analysis & Monitoring Unit and Chief, Financial Reporting & Grants Management Unit, DFAM.

Target date: January 2021

4 Macro- and micro-assessments

HACT requires that the type of cash transfer, and subsequent assurance activities, should be based on the risk of working with the partner. It follows that choice of the appropriate type of transfer must be done adequately if UNICEF is to achieve HACT objectives. This means it must be based on an assessment of the partner in question.

There are two types of assessment under HACT. First, there is the macro-assessment of a country's financial management system. Second is the micro-assessment, which looks at the specific partner. Under the framework, this should be done for all partners (both NGOs and Government partners) who are expected to receive US\$ 100,000 or more each in a calendar year, or else the partner should be assumed to be high risk.

The audit noted the following.

Conduct of macro-assessment: A macro-assessment is a desk review of a country's financial management system. Once conducted, a macro-assessment report is available to all UN agencies including UNICEF.

UNICEF no longer requires a macro-assessment. Its view after some years' experience is that the macro-assessment did not improve risk awareness and mitigation and was done for compliance purposes only. OIAI concurs with this view and notes that country offices may, if they wish, use the Public Expenditure Financial Accountability (PEFA) assessment as an alternative; this reviews over 60 indicators (the macro-assessment consists of only 15 questions).⁸ However, OIAI also agrees that offices may, if they wish, use the results of a macro-assessment if available.

Conduct of micro-assessments: The micro-assessment assesses an individual partner's capacity to properly manage funds and establishes a risk rating (High, Significant, Medium or Low) based on the assessment.

The risk rating for a specific partner is later used in deciding the appropriate type of cash transfer. It should also be used to determine the type and frequency of assurance activities, including spot checks, programmatic visits, and audits that will be needed for UNICEF to obtain adequate assurance that the cash provided to that partner has been used as intended. It is therefore important, first, that the micro-assessment be effective; and second, that any high risks identified are responded to in line with the applicable HACT procedure. If an office cannot conduct a micro-assessment for any reason, they must assume the partner is high risk.

A number of country offices had used professional accounting firms to conduct the micro-assessments. OIAI considers this as a good practice. However, OIAI also noted that UNICEF had required the firms to use a specific standardized internal control questionnaire that focused on generic control points to conduct micro-assessments. Predetermined procedures are known to be limited in terms of their nature and extent. Professional firms can often obtain greater assurance employing their own procedures and professional judgment. There was a risk that the firms, using the standardized procedures, would not identify the significant

⁸ The PEFA programme was founded in 2001 by a group of major donor organizations and donor governments. The objective was to produce a standard framework for assessment of countries' public financial management. More information on PEFA and how it works, and assessment reports, can be found at <https://www.pefa.org>.

risks of working with a given partner and that decisions made based on these assessments might not therefore achieve the desired level of assurance on the use of funds.

Offices also did not always micro-assess partners that met the set threshold of at least US\$ 100,000 in cash received in a calendar year. They often assumed the partners were high risk instead. In 2018, this was the case for 1,000 of the approximately 3,000 partners that met the threshold for micro-assessment. The HACT guidance does allow this under exceptional circumstances;⁹ however, those circumstances were not clearly set out in the procedures.

Use of micro-assessment: DAPM acknowledged that offices always worked with partners regardless of the risk rating. In OIAI's view, this is not in accord with the principle of HACT, which does not preclude working with high-risk partners but requires offices to assess the risks of working with the before money is transferred. In the absence of a micro-assessment, UNICEF does expect offices to implement assurance activities, but these take place after funds have been exposed to any heightened risk of fraud and irregularities that a micro-assessment might have detected – allowing an office to either choose another type of cash transfer, or adapt the partnership accordingly, or even not work with that partner if necessary.

If they are properly conducted, and the results are used in the right way, micro-assessments are likely to result in improved financial management capacities of partners. However, as indicated above, existing HACT guidance does not appear to be consistently applied to prevent or mitigate potential risks before disbursing money, but rather focuses primarily on detective controls were conducted after significant amounts of cash have already been disbursed to high-risk partners. Moreover, OIAI noted that the risk ratings of partners as determined by micro-assessments (or assumed) were not always used in planning and scheduling assurance activities, which defeats the object of a risk-based approach. (This is discussed in the following observation, *Assurance activities*.)

Types of payment: In general, offices also did not use the particular payment method required by the partners' risk ratings as established by their micro-assessments. The HACT framework provides for three methods of payment, depending on the level of risk applicable to the partner. An office can provide an advance to a partner prior to the activity being implemented, reimburse the partner after completion of the activity, or make direct payment to the partner's supplier. For significant and high-risk partners, the UNICEF HACT recommends the latter two methods be used.

In practice, however, the advance method was also used for high-risk partners. For example, in 2018, of the US\$ 2.2 billion cash assistance, 80 percent was in advances (US \$1.8 billion), 10 percent (US\$ 216.4 million) was paid directly and 10 percent was reimbursed (US\$ 211.8 million). During the same period, approximately 40 percent of payments made to high and significant risk partners were made as advances. OIAI noted that advances were preferred because partners generally did not have funds to pre-finance UNICEF supported activities.

Further, there was no systematic evidence of action to address internal control weaknesses identified during micro-assessments, and make improvements accordingly. According to the HACT framework, offices should consider financial capacity development for high-risk partners. While this audit and several previous audits have noted that country offices have implemented capacity-building activities, these were mainly conducted on an *ad hoc* basis. There seemed to be little systematic evidence to show that actions to address internal control weaknesses identified during micro-assessments had been tracked and monitored. While the

⁹ For example, DAPM explained that it expects such risk rating for new partners in humanitarian response as waiting for the results of an assessment would delay implementation.

inSight dashboard¹⁰ includes one indicator related to capacity development – the number of events completed in a year – this does not in itself indicate improvement in a partner’s financial management capacity. OIAI was provided with no capacity-building plans that could be linked to specific findings noted during micro-assessments.

There were varied understandings of what capacity development entails in the HACT context and how it should be planned, executed, and evaluated. In general offices had used training workshops, although other activities – such as supporting the establishment of proper systems for partners – may be more effective.

Agreed action 5 (medium priority): DAPM and DFAM agree to strengthen and more consistently enforce the requirements for micro-assessments and use of the results of these assessments in deciding on: (i) whether to work with partners; (ii) the cash transfer modalities to use; and (iii) frequency and type of assurance activities. A partner should have the relevant capacities, financial management skills and internal control systems before significant amounts of cash is put at their disposal. For timely identification deficiencies in partners’ systems and capacities, UNICEF should consider making a stronger requirement for assurance activities in situations where timely micro-assessments are deemed not to be feasible. Consideration should also be given to UNICEF-supported mitigation plans for potential partners in situations where it is challenging to source qualified partners.

Responsible staff members: Chief and HACT Manager, Implementation Unit, DAPM; Chief, Financial Reporting, Analysis & Monitoring Unit, DFAM.

Target date: July 2021

5 Assurance activities

Under HACT, there are three types of assurance activities to determine whether the funds transferred to partners have been used for their intended purposes. These are:

- On-site reviews (spot checks) of samples of partners’ financial transactions.
- Programmatic visits. These assess a partner’s actual implementation against the agreed workplan.
- Scheduled audits of partners.

The proper scheduling of assurance activities should contribute to their effectiveness. This is particularly critical since, as discussed in the previous observation, the required micro-assessments were not always conducted – and when they were, offices did not always use the results of the assessment for the intended purposes.

The audit noted the following.

Scheduling of assurance activity: For spot checks, offices did strive to use the partners’ risk rating (as determined by the micro-assessments, or assumed high risk) to select and schedule programmatic visits. They also considered the amount of cash transfers when selecting and scheduling programmatic visits. However, this was not always the case for programmatic visits and audits of partners. For programmatic visits, country offices had sought to comply with the

¹⁰ inSight (sic) is the performance component in UNICEF’s management system, VISION (Virtual Integrated System of Information). inSight streamlines programme and operations performance management, increases UNICEF staff access to priority performance information, and assists exchanges between country offices, regional offices and HQ divisions, as everyone sees the same data/information.

UNICEF-specific minimum requirements. In fact, the programme document signed with specific partners typically required more programmatic visits than the minimum requirement in the HACT guidelines. But the assurance plans did not reflect this requirement for additional programmatic visits.

Similarly, the selection of partners for audits had not been informed by the risk ratings as determined by the micro-assessments. Prior to 2019 when DAPM assumed responsibility for the selection of partners for audits, country offices used a financial threshold to select partners for audit. This threshold did not necessarily take into consideration the financial management capacity and quality of the partners' internal controls as determined by their micro-assessments.

After assuming responsibility for the selection of partners for audits, DPAM introduced a four-tier approach including a monetary threshold, results of prior audits, requests from country offices, and some random selections. This approach had been used since 2019. It did improve the selection process. However, OIAI noted that, of the 149 partners selected by DAPM for audit in 2019, over half were chosen because the particular country office had expressed a desire to have them audited rather than an application of the other selection criteria. In OIAI's view, this indicated the need for further improvement in the selection process, to make it more risk-focused and reduce subjectivity on the part of country offices and exclusion of partners from audit requirements.

The audit noted that offices tended to aim for compliance with the minimum requirement set by UNICEF HACT procedures largely because offices' HACT performances are monitored and measured against the minimum requirements set in HACT procedures.

Execution of assurance activities: The audit acknowledged as a good practice the use of professional accounting firms by all offices to conduct audits of selected partners, and by some offices for spot checks. However, it was also noted that even though UNICEF requires offices to commission special audits when 'significant' issues are identified during programme implementation, there was no guidance or criteria for offices to use in assessing the 'significance' of issues.

There is no centrally held data on how many special audits were commissioned and the specific reason why each of these were conducted. A review of HACT assurance activities in a sample of country offices showed that most had one or no special audits and only a few had a higher number. UNICEF requires offices to obtain OIAI's clearance of the terms of reference (ToR) for the special audits. In practice, however, OIAI seldom received such requests. This may indicate a low number of special audits, or could suggest that offices were not commissioning the audits when they should have done.

To conduct spot checks, DAPM required the professional accounting firms to use specific standardized procedures. There is therefore a risk that the accounting firms could focus solely on compliance with agreed-upon procedures, rather than having sufficient scope to use their professional judgment to identify and conduct appropriate procedures for evaluating risks and detecting unintended use of funds by partners.

Integration into general monitoring activities: UNICEF has wider programme monitoring requirements beyond those specified under HACT. For example, the wider requirements cover programme supplies, while the HACT-related requirements do not. Some offices had combined HACT and non-HACT monitoring visits, while others did things separately. There was thus a risk that programme monitoring may not be as effective and efficient as it could be across UNICEF. It may be useful for UNICEF to consider integrating the requirements for

HACT-specific programmatic visits into the wider programme monitoring requirements.

Follow-up and use of assurance activities: In general, offices were not conducting adequate follow-up of questioned and unsupported costs, and in general there was insufficient evidence they were taking timely action on the findings of assurance activities. For instance, OIAI found that one office had not followed up with Government partners on expenditure totalling US\$ 1.13 million that had been questioned by assurance activities. For another office, the questioned costs not followed up over a long period was about US\$ 600,000. (Subsequently, in response to OIAI audits, these offices did take action.)

Also, offices sometimes gave partners extra time to find supporting documentation for ineligible expenditures, rather than start a formal follow-up process and/or action to recover the funds in question. It is acknowledged that there may be situations where the need for additional documentation is valid; for example, where the requisite documents are in a field office and need to be moved to the head office. Barring such exceptional circumstances, however, questions remained as to transparency of the process followed by offices in deciding not to pursue recovery of questioned or unsupported expenditure. There may be a risk that partners could exploit the extra time to fabricate supporting documentation.

Priority of findings: UNICEF HACT guidance requires offices to: classify all findings made by spot checks as either high or low priority; follow up high-priority findings; and take appropriate action when a programmatic visit report has high-priority observations. The guidance also requires appropriate follow-up action when a scheduled audit report contains a disclaimer (e.g. the auditor states that they cannot give an opinion), or qualified or adverse opinions or significant high-priority findings.

However, the audit noted that there were no clear criteria and guidance on how to assess the priority levels of findings and observations made by programmatic visits. UNICEF procedures require only that when the programmatic visit report includes high-priority findings and observations, the most appropriate course of action be determined. In practice, OIAI noted inconsistent and often poor documentation of follow-up actions and deadlines.

For scheduled audits, there is guidance on the materiality of questioned/ineligible expenditures identified; however, there is no guidance on the assessment of internal control weaknesses with unquantifiable financial consequences. In the HACT procedure, appropriate action refers only to impairment or write-off of ineligible expenditures. The procedure does not require an office to pursue other remedial actions, such as refunds and requiring partners to address weak financial management controls identified by the audits.

Agreed action 6 (medium priority): DAPM, in liaison with relevant stakeholders, agrees to review and streamline guidance on programmatic visits under HACT, and on wider programme monitoring, to ensure the economy, effectiveness and efficiency of programme monitoring across country offices.

Responsible staff members: Programme Monitoring Manager, Performance Management Unit, DAPM

Target date: July 2021

Agreed action 7 (medium priority): DAPM and DFAM agree to review and improve guidance to increase risk-based selection and prioritization and execution of assurance activities. This should include follow-up of these activities and use of results.

Responsible staff members: Chief and HACT manager, Implementation Unit, DAPM; Chief, Financial Reporting, Analysis & Monitoring Unit; and Chief, Financial Reporting & Grants Management Unit, DFAM.

Target date: July 2021

Agreed action 8 (medium priority): DAPM and DFAM agree to put in place a system including key performance indicators for finalizing assurance activities, timely recording and effective evidenced-based follow-up of questioned costs and control weaknesses identified during assurance activities.

Responsible staff members: Implementation Unit (Chief and HACT manager), DAPM; Chief, Financial Reporting, Analysis & Monitoring Unit and Chief, Financial Reporting & Grants Management Unit, DFAM.

Target date: July 2021

Annex A: Methodology, and definitions of priorities and conclusions

The audit team used a combination of methods, including interviews, document reviews, testing samples of transactions. It also visited UNICEF locations and supported programme activities. 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. With support from the relevant regional office, the country office reviews and comments upon a draft report before the departure of the audit team. The Representative and their staff then 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 auditees (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 auditing 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 in the Summary fall into one of 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 office 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 the office were generally established and functioning during the period under audit.

[Qualified conclusion, strong]

Based on the audit work performed, OIAI concluded that the controls and processes over the office needed improvement to be adequately established and functioning.

[Adverse conclusion]

Based on the audit work performed, OIAI concluded that the controls and processes over the office needed **significant** improvement to be adequately established and functioning.