

**UNDP Office of Audit and Investigations
UNFPA Division for Oversight Services**

**Joint Audit
of
the Governance Arrangements
for
the Harmonized Approach to Cash Transfers
(HACT)**

DOS report # OED111

OAI report # 1064

Issue date: 9 November 2012

Executive Summary

1. As part of a series of joint audits of the implementation of HACT and with the involvement of the Office of Internal Audit and Investigations (OIAI) of the United Nations Children's Fund (UNICEF), the Division for Oversight Services (DOS) of UNFPA as lead auditor and the Office of Audit and Investigations (OAI) of UNDP conducted a joint audit of the *governance arrangements for the Harmonized Approach to Cash Transfers (HACT)*. The audit, which was performed between October and December 2011 at New York Headquarters through desk reviews, interviews and surveys, was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.
2. The objective of the audit was to assess whether governance arrangements in place at the corporate level were adequate to support an effective implementation of HACT and the achievement of HACT objectives (improved risk management; cost reduction; simplification and harmonization of procedures, and strengthening of national capacity), assisted by a harmonized and well defined accountability and monitoring structure; a clear assignment of authorities and responsibilities; and the existence of appropriate policies, procedures and tools.
3. This audit assessed the corporate governance arrangements for HACT as '**Unsatisfactory**'. This means that internal controls, governance and risk management processes were either not established or not functioning well; the issues identified were such that the achievement of the overall objectives of HACT could be seriously compromised.
4. In 2005, HACT was launched as a step towards the implementation of the United Nations General Assembly Resolution 56/201, which calls for the simplification and harmonization of rules and procedures in the United Nations system. HACT represented a shift from assurance for cash transfers derived from project level controls and audits towards assurance derived from system-based assessments and audits. HACT aims at reducing transaction costs and was promoted as a response to the Rome Declaration on Harmonization and Paris Declaration on Aid Effectiveness, which call for the alignment of development aid with national priorities and needs, focusing more on strengthening national capacities for management and accountability. The policies and procedures for the implementation of HACT are contained in the Framework for Cash Transfers to Implementing Partners (HACT Framework), which was adopted by the United Nations Development Group (UNDG) in April 2005.

Progress of HACT implementation

5. Six years after the 2005 roll out of the HACT Framework, only two, Bhutan and Tanzania, of the more than 150 countries tracked by the United Nations Development Operations Coordination Office (UNDOCO), are commonly applying HACT across UNDP, UNFPA and UNICEF. The 2011 UNDG annual progress report shows that only 29 countries, or 19 per cent of the countries tracked, have assessed themselves as HACT compliant. 31 per cent of the countries had still not completed the macro assessment of the country's Public Financial Management system; more than half of the countries (53 per cent) had yet to complete the micro assessments of their implementing partners (IPs); and more than two thirds of the countries (68

per cent of the countries) had yet to establish joint assurance and audit plans. The limited implementation of HACT is mainly attributed to difficulties in inter-agency coordination and lack of resources at the country level.

Achievement of HACT objectives

6. For the current project-based audit process in UNDP and UNFPA (National Implementation/National Execution or NIM/NEX audits), the move to HACT constitutes a shift from centrally managed and monitored audits, with decisions on expenditure thresholds, level of assurance to be obtained and, in the case of UNFPA, on the selection of the auditors made at Headquarters. Given that project audits are performed by audit firms, the level of effort required from country offices (COs) is limited. The HACT process, instead, is highly decentralized, and delegates decision-making (such as thresholds for micro assessments, scope of assurance activities to be performed, and level of testing to be conducted) to the country level. The delegation of decision-making without any central oversight or clearance mechanisms has contributed to major inconsistencies in the implementation approach between countries. It also does not allow management at Headquarters to aggregate the level of assurance obtained over cash transfers, particularly for financial reporting purposes. Furthermore, given that certain assurance activities (i.e., spot checks) are expected to be conducted by agency staff, the process adds a significant workload and requires competencies in risk management and audit that might not be available at COs.

7. HACT has provided useful tools to harmonize and simplify the capacity assessment of implementing partners, through the use of micro assessments. HACT has also contributed to harmonizing and simplifying the cash transfer process, through the use of Funding Authorization and Certificate of Expenditures (FACE) forms. However, there is no evidence, as also noted in country office audits performed by the Internal Audit Services of the different agencies, that HACT's objective to promote and achieve capacity development is being achieved. Furthermore, there is no documented evidence that HACT has contributed to any cost reduction.

HACT instruments

8. The macro assessment, a tool designed to identify strengths and weakness in the country's Public Financial Management (PFM) system and to assist in the establishment of appropriate cash transfer modalities and assurance activities to be performed by the agencies, is not consistently used for that purpose. COs have reported limited integration of the macro assessment results into the United Nations Development Assistance Framework (UNDAF) results matrix and the HACT implementation plan.

9. The micro assessments have not been used as an effective tool for managing financial risk and determining the cash transfer modality and assurance activities for specific IPs. Limitations encountered in the use of micro assessments include: (i) difficulty of inter-agency coordination of the assessments; (ii) inability to source qualified firms to produce high quality assessments; and (iii) difficulties associated with managing the high volume of assessments required. Furthermore, the fact that the HACT Framework delegates the establishment of thresholds for micro assessments to the United Nations Country Team (UNCT), combined with

the lack of guidance on how to assign risk levels, has resulted in major inconsistencies in the use and results of micro assessments at different countries.

10. Joint assurance and audit plans have been prepared by only 32 per cent of the countries. The number of countries that have implemented the joint plans is not tracked. Joint HACT and CO audits performed by the Internal Audit Services of participating agencies have shown that activities included in the joint assurance and audit plans are often not executed as planned. This is mainly attributed to: (i) difficulties in inter-agency coordination of assurance activities; and (ii) lack of resources at the country level. In addition, the HACT Framework lacks clear guidance on the impact of the different risk levels assessed for IPs over the frequency and scope of the related assurance activities.

HACT roles, responsibilities and accountability

11. Accountability over HACT implementation at the global level is unclear and not documented. Further, there is confusion over accountability at the country level. While some stakeholders identify the Resident Coordinator (RC) as having overall responsibility over HACT, others noted that, given the lack of authority of the RC to enforce implementation, accountability lies at the CO Representative and Regional Director levels of each organization. Review of the performance appraisals of Representatives of the top 10 COs (by expenditure level) and Regional Directors at UNFPA showed that HACT is not an element in their performance plans and appraisals.

12. The effect of the lack of clarity on HACT roles and responsibilities was specifically noted during the issuance of this report. The draft report was sent to the HACT Advisory Committee (HACT AC) which, based on discussions conducted with different stakeholders including Controllers, was considered to be responsible for inter-agency policy advice and coordination as well as technical guidance and support. However, the HACT AC advised that the recommendations should be addressed to the management of the individual agencies, with the HACT AC assuming the facilitation and coordination role. In the view of the Internal Audit Services, gaps and deficiencies in system-wide policies cannot be addressed at the level of individual agencies only, but require a coordinated approach by an inter-agency body. While it is incumbent on the UNDG to make such decisions, in our opinion, it is the responsibility of the HACT AC to provide policy advice to the UNDG.

HACT monitoring and verification

13. Monitoring of HACT implementation is conducted by a number of offices with the participating agencies with limited to no coordination. Monitoring of implementation at the UNCT level is performed by UNDOCO on behalf of UNDG. However, the monitoring is based on self-reporting; as a result, there is no verification of data, creating concerns over the overall accuracy of reports generated. Within each agency, monitoring of implementation at the CO level is performed by the NEX Unit in the Division for Management Services at UNFPA; the Office of Finance and Administration (OFA) at UNDP; and the Office of the United Nations and Inter-Governmental Affairs at UNICEF. While limited coordination takes place between UNDP and UNFPA, there is no coordination with UNICEF. The monitoring by different units and

agencies combined with the lack of coordination resulted in the reporting of different HACT compliance figures: (i) UNDG reported 29 compliant countries; (ii) UNFPA reported 9 compliant countries; (iii) UNDP reported 61 compliant countries (of which so far only six have adopted the HACT audit regime, i.e. opted out of NGO/NIM audits and have been verified as compliant); and (iv) UNICEF reported 60 compliant countries.

14. While verification of data reported by COs is conducted by the NEX Unit at UNFPA and, in the case of a change in audit regime, OAI at UNDP, the extent of the verification does not provide sufficient assurance that the HACT process was properly planned and implemented. To that end, verification activities should also include the assessment of: (i) the appropriate assignment of risk levels to IPs; (ii) the selection of the appropriate type of cash transfer modality; (iii) the planning of assurance activities commensurate with the risk levels assigned to IPs; and (iv) the confirmation of execution and quality of the assurance activities contemplated in the joint assurance plans.

15. Inter-Agency coordination at the global level is conducted through the HACT AC. The HACT AC was mainly composed of programme staff with limited finance and audit expertise. In addition, it lacked sufficient senior level management representation, as most of its members were not empowered to make decisions on behalf of their agencies. The approved Terms of Reference (TOR) of the HACT AC do not provide identifiable outputs and activities. However, in June 2011, the HACT AC commissioned a global assessment of HACT (Global Assessment) to guide its activities in 2012.

HACT compliance criteria

16. The criteria for HACT compliance do not currently require confirmation that planned assurance activities have been implemented. The criteria only require confirmation that a joint audit and assurance plan is in place, not considering the extent to which assurance and capacity development activities have been implemented.

17. Overall, the report highlights significant gaps and shortcomings within guidelines and practices that justify an assessment of the extent to which the HACT modality has met its objectives. Should the assessment demonstrate a positive impact of HACT on the effectiveness of United Nations Country Teams in programme countries, this review would have to be followed by a thorough revision of the HACT guidelines to get the process fully harmonized and more reliable.

Audit recommendation and management comments

18. The findings and a first set of recommendations resulting from this audit were discussed, on the basis of a draft audit report, with members of the HACT AC and with representatives of UNDOCO at an Exit Meeting on 6 February 2012. In March 2012, the HACT AC provided comments. DOS and OAI welcomed the clarifications and corrections provided by the Committee. However, the Committee disagreed with most of the audit recommendations made in the draft version and which were directed at the Committee, pointing out that recommendations should be addressed instead to the management of individual participating organizations.

19. DOS and OAI therefore reviewed the draft report and modified its presentation, concluding that a single recommendation should be brought up to the attention of the UNDG.

20. The UNDG should task an inter-agency team to revisit, in consultation with management of the individual agencies, the Harmonized Approach for Cash Transfers Framework, and decide to redesign it, as appropriate, ensuring that the issues identified by the joint audit which are further detailed in this report, are addressed and seeking the views of the United Nations Board of Auditors on the acceptable assurance levels. Alternatively, the UNDG may wish to consider a new, different yet effective policy or approach that would achieve the same objectives intended by the HACT Framework, while encompassing the points raised in this report.

21. In its answer, the Director of UNDOCO, together with the Chair of the HACT AC, agreed on the need for clearer guidance on assigning risk levels and determining the appropriate cash transfer modalities and required assurance activities. Dissenting comments were made on the role of the HACT AC (not a monitoring body), the meaning of ‘HACT compliance’ (existence – and not appropriateness – of assurance activities at a given risk level; whether HACT implementation by all agencies determine HACT compliance), on risk management (the absence of either macro or micro assessments not being a deficiency, as operations may continue under the assumption of ‘high risk’, with relevant assurance measures), and on performance (the low number of common IPs not being considered an indicator of sub-performance).

22. The Internal Audit Services of UNDP and UNFPA take note of dissenting views; based on the work performed and presented herein, they remain of the opinion that the governance, risk management and internal control processes are not working sufficiently well to ensure that the achievement of the overall objectives of HACT - i.e. better risk management, reduction in costs, simplified and harmonized processes and national capacity development – is not seriously compromised.

23. Notwithstanding the above, the UNDOCO and the HACT AC indicated that action was undertaken to launch a revision of the HACT Framework. The Internal Audit Services of UNDP and UNFPA look forward to its implementation.

24. We would like to thank the managers and staff of UNDP, UNFPA, UNICEF and UNDOCO, as well as the Chair and members of the HACT AC for their cooperation and assistance throughout the audit.

[Signed]

Fabienne Lambert, Director

Division for Oversight Services
UNFPA

Egbert C. Kaltenbach, Director

Office of Audit and Investigations
UNDP