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

ABBREVIATIONS

AWP	Annual Work Plan
CEB	Chief Executives Board for Coordination
CCA	Common Country Assessment
CO	Country Office
CPAP	Country Programme Action Plan
DOS	Division for Oversight Services (UNFPA)
FACE	Funding Authorization and Certificate of Expenditures
HACT	Harmonized Approach to Cash Transfers
HACT AC	HACT Advisory Committee
HLCM	High Level Committee on Management
IP	Implementing Partner
IPSAS	International Public Sector Accounting Standards
NEX	National Execution
NEXAMS	National Execution Audit Management System
NGO	Non-governmental Organization
NIM	National Implementation
OAI	Office of Audit and Investigations (UNDP)
PFM	Public Financial Management
RC	Resident Coordinator
SAI	Supreme Audit Institution
TOR	Terms of Reference
UNBOA	United Board of Auditors
UNCT	United Nations Country Team
UNDAF	United Nations Development Assistance Framework
UNDG	United Nations Development Group
UNDOCO	United Nations Development Operations Coordination Office
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Population Fund
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children’s Fund
UN Women	United Nations Entity for Gender Equality and the Empowerment of Women
WFP	World Food Programme
WHO	World Health Organization

Contents

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.

<u>Progress of HACT implementation</u>

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 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.

<u>HACT roles, responsibilities and accountability</u>

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.

<u>HACT monitoring and verification</u>

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	Egbert C. Kaltenbach, Director
Division for Oversight Services UNFPA	Office of Audit and Investigations UNDP

A. Objectives, Scope and Methodology

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 of the United Nations Children's Fund (UNICEF), the Division for Oversight Services (DOS) as lead auditor and the Office of Audit and Investigations (OAI) of the United Nations Development Programme (UNDP) conducted a joint audit of the *Governance arrangements of the Harmonized Approach to Cash Transfers (HACT).* The audit, which was performed between 31 October and 2 December 2011 at New York Headquarters, 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. This includes the achievement of HACT objectives, 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. The audit covered the period since the inception of HACT in 2005 to December 2011.

3. The audit was conducted through a combination of desk review of documentation available from UNDG, analysis of monitoring reports made available through UNDG, UNFPA, UNDP and UNICEF, interviews with the respective agencies management at Headquarters and with management and staff members at selected COs, and a web-based survey of 10 COs. It also built upon the results of previous joint or agency audits of HACT implementation at the country level (Indonesia; Malawi; Pakistan; Vietnam). The audit also took into consideration the December 2011 report of the Global Assessment of the Harmonized Approach to Cash Transfers (HACT), which was commissioned by the HACT Advisory Committee to conduct an in-depth analysis of the challenges in the HACT implementation process and to provide recommendations to improve the management and strengthen the implementation of HACT.

4. The findings and recommendations resulting from this audit were discussed, on the basis of a draft audit report, in an Exit Meeting on 6 February 2012 with members of the HACT AC and with representatives of the United Nations Development Operations Coordination Office (UNDOCO). 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 that version, which were directed at the Committee, pointing out that recommendations should be addressed to the management of individual organizations. Hence, DOS and OAI reviewed the draft report and modified its presentation to the present version.

B. Background

5. HACT was introduced in 2005 in response to the Rome Declaration on Harmonization and Paris Declaration on Aid Effectiveness, which calls for alignment of development aid with national priorities and needs and promotion of the strengthening of national capacities for management and accountability.[1] HACT takes into consideration the United Nations General Assembly Resolution 56/201, which calls for the simplification and harmonization of rules and procedures in the United Nations system with the aim of reducing the high transaction costs[2].

6. To operationalize HACT, UNDP, UNFPA, UNICEF and WFP, through the working group on Resource Transfer Modalities, developed a comprehensive Framework which details the harmonized and simplified procedures that are expected to be used by the agencies in order to manage transfers of cash to IPs, under HACT, a process expected to be based on the management of risk rather than on a system of controls and project audits. The Framework was rolled out on 28 April 2005.

7. Inter-Agency coordination of HACT at the country level is performed through the RC, as the Chair of the UNCT. Inter-Agency coordination of HACT at the global level is performed through the HACT AC, which was initially established in 2004 as a working group on Resource Transfer Modalities and charged with the responsibility of developing the Framework. Upon the development of the Framework, the team was restructured into an advisory committee in charge of providing policy level advice for the roll-out, implementation and monitoring of HACT. In 2006, the group was renamed HACT Advisory Committee and is comprised of members representing the programme, finance and audit departments of the participating agencies[3]. The Committee is supported by UNDOCO in its coordination function, mainly by facilitating the communication between members.

8. Monitoring the implementation of HACT is performed by a number of agencies and units, albeit using different methodologies and levels of monitoring. UNDG performs its HACT progress monitoring on a country level basis through self-reported information by the RC. UNICEF performs HACT progress monitoring on a CO level through information self-reported by the COs. At UNDP, the Office of Finance and Administration (OFA) monitors HACT implementation through information self-reported by CO, while the Office of Audit and Investigation (OAI) performs validation reviews of reported information for CO that are HACT compliant and wish to opt out of the NGO/NIM audit mechanism and implement HACT assurance instead. At UNFPA, the National Execution (NEX) unit within the Division for Management Services (DMS) performs monitoring and verification of the information reported by COs, through the use of a global audit firm.

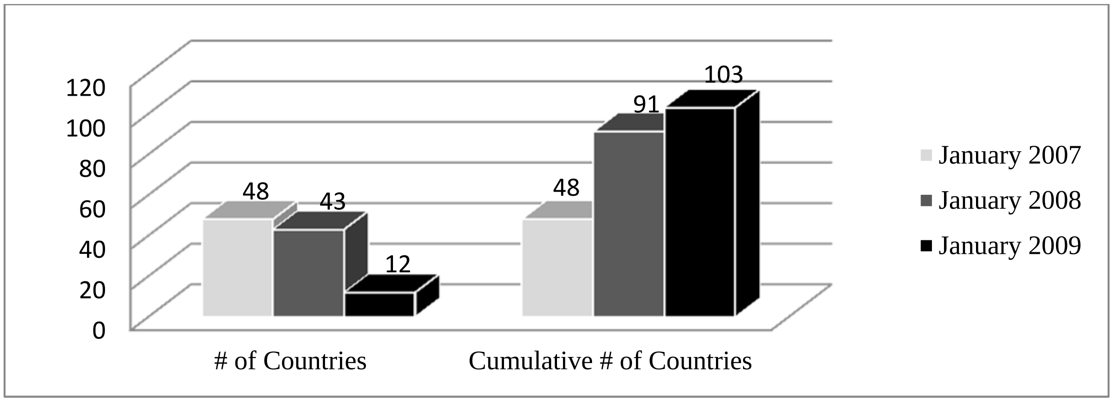
[1] HACT – Responses to key Implementation Challenges, page 1.
[2] A/RES/56/201.
[3] HACT Advisory Committee – Draft Terms of Reference.

C. Progress of HACT Implementation

C.1 Progress of full HACT compliance

9. Per the 2008 UNDG annual progress report and as shown in *Figure 1* below, 103 countries planned to be HACT compliant by 1 January 2009.

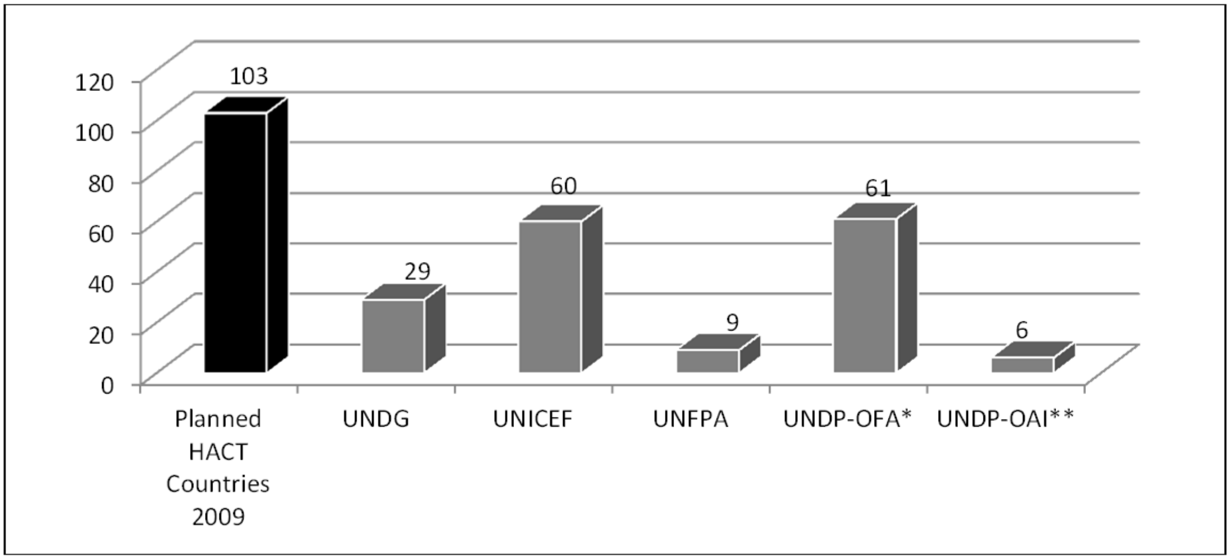
Figure 1 - HACT implementation deadlines



Source: 2008 UNDG Annual Progress Report

10. However, HACT implementation has not progressed as planned. As shown in *Figure 2* below, the number of HACT compliant countries, as reported by the 2011 UNDG annual progress report, was only 29 countries, or 28 per cent of the total number of countries planned to be compliant by January 2009 (see country names in Annex 4).

Figure 2 - Planned vs. actual HACT compliance as reported by each entity



Source: 2008 and 2011 UNDG Annual Progress Reports
**Country offices that have self-reported to be HACT compliant.*
***HACT compliant country offices that have moved away from the NGO/NIM audit mechanism and which OAI had validated the country offices' HACT compliance.*

11. UNDG, UNFPA, UNDP and UNICEF have all been tracking HACT compliance separately and reporting inconsistent results. As shown in *Figure 2*, the list of countries currently considered to be HACT compliant by UNICEF, UNDP and UNFPA varies significantly from the number reported by UNDG. UNDG is the only entity that tracks compliance at a country level as reported by the RCs; the other three agencies track compliance on a CO basis as reported by the CO Representatives.

12. This inconsistency is further discussed under Section F "HACT Monitoring and Verifications" later in the report. However, it is pertinent to note at this stage that the discrepancy noted is due to the following reasons:

a) The UNDG figures are based on data provided by the RCs and not verified by UNDG.
b) The UNICEF figures are based on data reported by the UNICEF's COs' and not verified by UNICEF headquarters.
c) The UNDP and UNFPA figures are also based on each respective agency's COs' reported implementation status (both agencies follow a slightly different verification process to validate the implementation status reported by the COs).

13. The HACT Committee has indicated that no country should be considered HACT compliant unless assessed as such and applying HACT by all participating agencies[4]. Under this criterion, only two countries, Bhutan and Tanzania (which, as shown in *Table 1* below account for a small fraction of global programme expenditures) would be HACT compliant, having been assessed as such by UNDG and the three agencies.

Table 1 - Total expenditures of countries commonly applying HACT - UNFPA, UNDP and UNICEF
As a percentage of total biennium CO expenditures - Amounts in thousands of US dollars

Country	UNFPA	UNDP	UNICEF
Tanzania	$ 8,419	$ 65,740	$ 38,347
Bhutan	$ 2,030	$ 11,356	$ 2,349
Total	**$ 10,449**	**$ 77,096**	**$ 40,696**
Total expenditures for the 2008-2009 biennium	$ 541,848	$ 8,696,538	$ 1,433,909
% for countries commonly applying HACT	**1.9%**	**0.9%**	**2.8%**

Source: For UNFPA and UNICEF –Financial Statements for the biennium ended 31 December 2009. For UNDP – Expenditures obtained from Atlas.

14. Such a low HACT compliance rate six years after the initial roll out is indicative that the Framework, in its current form, may not fully meet the needs and expectations of implementing partners and United Nations entities.

[4] HACT – Responses to Key Implementation Challenges, page 6.

15. As shown in *Table 2* below, UNFPA and UNDP, the two agencies which have implemented a process to verify HACT compliance status, reported only 9 and 6 country offices that have implemented and adopted HACT, respectively, accounting for 7.5 per cent of the total programme expenditures for UNFPA (with only 4 of the 9 countries ranked in the top 30 based on their expenditure level) and 3.9 per cent for UNDP (with only 1 of the 6 countries ranked in the top 30 based on their expenditure level)[5].

Table 2 - Total expenditures of COs that have implemented and adopted HACT at UNDP and UNFPA As a percentage of total biennium CO expenditures – Amounts in thousands of US dollars

Country - UNFPA[6]			**Country - UNDP**		
Country	**Amount**	**Top 30**	**Country**	**Amount**	**Top 30**
Mozambique	$ 10,135	Yes	Cape Verde	$ 21,176	**No**
Tanzania	$ 8,419	Yes	Tanzania	$ 65,740	**No**
Philippines	$ 7,743	Yes	Malawi	$ 62,976	**No**
Vietnam	$ 7,402	Yes	Morocco	$ 34,969	**No**
Thailand	$ 3,262	**No**	Indonesia	$ 146,267	Yes
Bhutan	$ 2,030	**No**	Bhutan	$ 11,356	**No**
Pacific Island Countries [7]	$ 1,880	**No**			
Total expenditures	$ 40,871		Total expenditures	$ 342,484	
Total expenditures for the 2008 – 2009 biennium	$ 541,848		Total expenditures for the 2008 – 2009 biennium	$ 8,696,538	
% for countries that have implemented and adopted HCAT	**7.5%**		**% for countries that have implemented and adopted HACT**	**3.9%**	

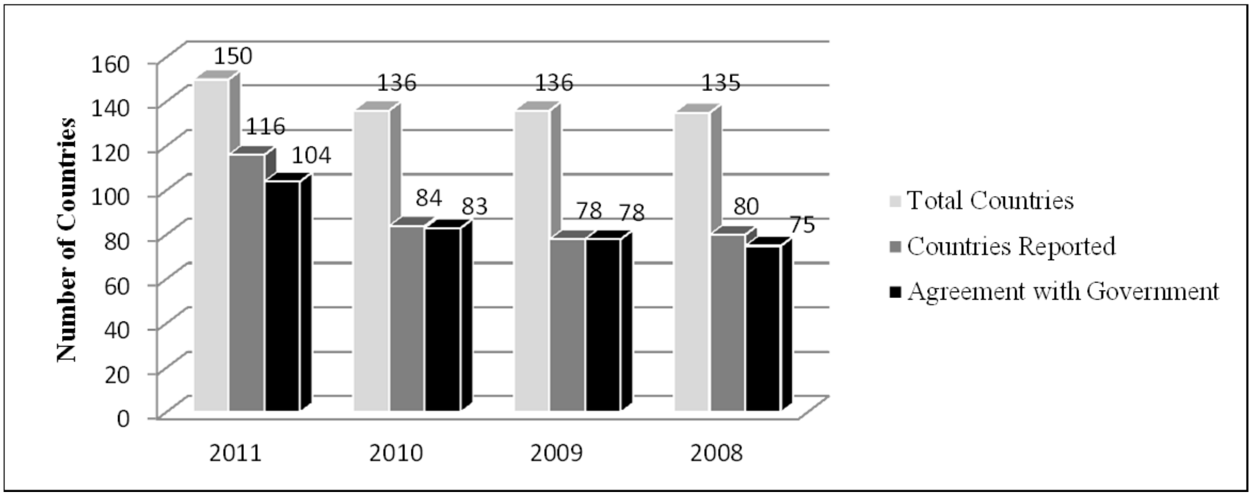
Source: For UNFPA and UNICEF –Financial Statements for the biennium ended 31 December 2009. For UNDP – Expenditures obtained from Atlas.

C.2 Progress on Government Agreements

16. *Figure 3* below reflects the status of government agreements for 150 countries tracked by UNDG, as reflected in its 2011 annual progress report. The increase from 136 countries in 2010 to 150 countries in 2011 is the result of separately reporting on 12 island states in the South Pacific, which are under the management of the UNCTs of either Samoa or Fiji. In addition, the Seychelles and South Sudan were added to the list of countries.

[5] The list of the top 30 countries by organization is included in Annex 7.
[6] According to its HACT definition
[7] Kiribati, Solomon Islands and Vanuatu

Figure 3 - Number of countries reported as having government agreement on HACT



Source: 2011 UNDG Annual Progress Report – full list by country name in Annex 6

17. As shown in the chart above, 46 countries (difference between total number of countries and of those with government agreement), or 31 per cent of the countries tracked, have not reached government agreement on HACT. While a number of countries have not reported the reasons for the lack of government agreement, others made reference to either the government's perception of HACT as interference with their national system, or reported low capacity and lack of transparency in the national accounting system as an issue. The Framework does not provide alternatives to HACT procedures in cases where government buy-in of the process is not obtained.

18. It should be noted that 34 countries, or 23 per cent of the total, did not report on their HACT implementation progress. Of this group, nine countries reported that HACT is not applicable; five countries reported that their HACT deadline has been postponed based on an UNCT decision; one country indicated that it had been granted a deferral from the Regional UNDG Directors Team. Nineteen countries, or 13 per cent of the total population tracked, did not report their status[8].

C.3 Progress on Capacity Assessments - Macro Assessment and Micro Assessments

19. As shown in *Figure 2*, a total of 103 countries, or 69 per cent of the countries tracked, reported having completed their macro assessments in 2011, compared to 83 countries in 2010. Twelve of the 103 countries that reported completion of the macro assessment did not have government agreement to proceed with HACT, raising questions as to the purpose of conducting the assessment when government buy-in for HACT had not been established[9]. A total of 70 countries, or 47 per cent of the total population, reported completion of their micro assessments in 2011, or assumed high risk for non-assessed IPs, compared to 47 countries in 2010.

[8] List of 19 countries that did not provide status update to UNDG in 2011: Ethiopia, Kenya, Mauritius, Seychelles, South Sudan, Zambia, Burkina Faso, Cameroon, Chad, Congo (PRC), Cote D'Ivoire, Gabon, Mali, Sao Tome & Principe, China, Indonesia, Pakistan, Sri Lanka and Romania.

[9] List of 12 countries that reported completion of the macro assessment without government agreement: Gabon, Guinea, Pakistan, Palau, Tuvalu, Azerbaijan, Belarus, Tajikistan, Turkey, Argentina, Barbados and Paraguay.

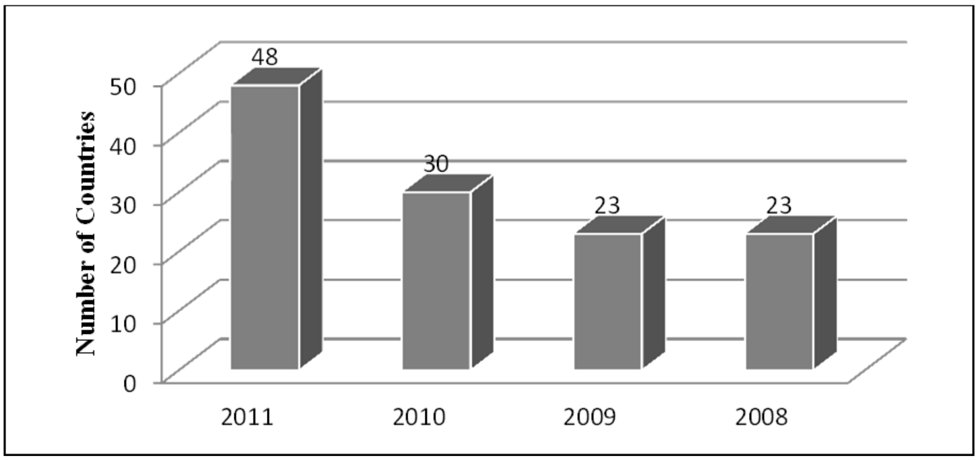
20. Four of the 70 countries that completed their micro assessment had not performed macro assessments. Presumably, they assumed high risk in lieu of conducting the macro assessment, an alternative that is not allowed by the Framework[10].

21. The cause for the low implementation rate for macro assessments is lack of government agreement. The UNDG annual progress report does not provide clear reasons for the low micro assessment implementation rate. However, as noted in the global assessment report, the main challenges when conducting micro assessments were: (i) Inter-Agency coordination issues; (ii) Quality of the micro assessments; and (iii) Managing the volume of micro assessments required.

C.4 Progress on Assurance Plans

22. As shown in *Figure 4* below, a total of 48 countries, or 32 per cent, reported to have completed joint assurance and audit plans in 2011, compared to 30 countries in 2010. Four of those 48 countries had not completed the macro assessments[11], and another 4 countries had not completed the IP micro assessments. One country, Cote d'Ivoire, reported completing the assurance plan without having completed any of the other requirements – agreement with government, macro and micro assessments.

Figure 4 - Number of countries that have completed the assurance and audit plan



Source: 2011 UNDG Annual Progress Report

23. While only 48 countries have reported completion of the joint assurance and audit plans, given the lack of review and validation of such plans by the UNDG, there is a high risk that they are either incomplete or inaccurate. This risk assessment is based on the result of the joint HACT audits and of regular agency audits performed in HACT countries, where the auditors noted the following:

[10] List of 4 countries that have completed the micro assessments without completing the macro assessments: Eritrea, Ethiopia, Burkina Faso and Sao Tome & Principe.
[11] List of 4 countries that have completed the assurance and audit plans without completing the macro assessments: Eritrea, Ethiopia, Burkina Faso and Sao Tome & Principe.

a) In one country, the threshold for scheduled audits was increased from $ 500,000 to $ 1 million, reducing the level of assurance effectively obtained[12].

b) In another country, an assurance plan was prepared. However, the plan did not cover the entire IP population and had not been updated to reflect changes to the list of IPs and the expected amounts of cash transfers[13].

24. According to the UNDG annual progress report, the main contributors to the low completion of assurance plans, based on the input provided by the countries tracked, are the lack of full commitment from the participating agencies and the lack of coordination between them.

25. In conclusion, while it is encouraging to note that specific instruments within HACT have been implemented, HACT compliance should not be assessed exclusively based on the completion of parts of but rather the entire HACT process, including the implementation of planned assurance activities. Without a rigorous implementation of planned activities, HACT will not provide any effective assurance over cash transfers.

D. Achievement of HACT Objectives

26. According to the Framework, HACT implementation should significantly reduce transaction costs and lessen the burden that the multiplicity of United Nations procedures and rules creates for its partners. These core goals would be achieved through the use by IPs of common forms and procedures to request cash and report on its utilization, and the use by agencies[14] of a risk management approach, including the selection of procedures for transferring cash to IPs based on joint assessments of their financial management capacity and coordinated activities to obtain assurance over the utilization of the funds provided. Such jointly conducted assessments and assurance activities should further contribute to the reduction of costs.

27. This approach should allow efforts to focus more on strengthening national capacities for management and accountability, with a view to gradually shift to utilizing national systems. It should also help agencies shape their capacity development interventions and provide support to new aid modalities[15].

D.1 HACT as a Risk Management Tool

28. The Framework acknowledges that there is a risk that transferred funds may not be used or reported in accordance with agreements between the agencies and the IPs. For each IP, the agencies are expected to manage this risk using the following mechanisms: (i) assess the IP's financial management capacity (macro and micro assessments); (ii) based on the results of the

[12] Joint Audit of the Harmonized Approach to Cash Transfers in Vietnam, page 7.
[13] Joint Audit of the Harmonized Approach to Cash Transfers in Malawi, page 11 and Indonesia, page 9.
[14] Throughout this report, the term "agencies" will be used to refer to the UNDG ExCom agencies and any other United Nations agencies that choose to adopt these procedures.
[15] Framework for Cash Transfers to Implementing Partners, page 2.

assessments, select the appropriate cash transfer modality; and (iii) maintain adequate awareness of the IP's internal controls for cash transfers through assurance activities[16].

29. While the risk management practices considered within the Framework may be conceptualized as a good practice, there is a concern, as explained in the paragraphs below, that they might not provide an appropriate level of assurance as to whether the funds transferred were used for the agreed-upon purposes and in accordance with the stipulated procedures, particularly in comparison to the level of assurance currently provided through NIM and NEX project audits at UNDP and UNFPA.

30. Per the Framework, the agencies should assess risks associated with cash transfers to IPs before initiating any such transfers. The two types of risk assessments required are the macro and micro assessments.

D.1.1 Macro assessments

31. The macro assessment supports the agencies and government to identify strengths and weaknesses in the country's public financial management (PFM) system and areas for capacity development by the government and others. The macro assessment (in combination with the assessment of IPs) assists in the establishment of appropriate cash transfer modalities, procedures, and assurance activities to be applied by the agencies. Furthermore, the macro assessment's findings related to the national audit system establish whether the audit system can be relied on to conduct the required audits of IPs who receive cash transfers. The macro assessment is expected to be undertaken once per programme cycle during the Common Country Assessment (CCA) preparation, and may be updated whenever significant changes in the country's governance system are observed[17].

32. The macro assessment report should identify the key risks that the PFM system poses to the functioning of the cash transfer framework; an assessment of the Supreme Audit Institution's capacity to undertake required audits; and suggested opportunities for capacity development (if any)[18].

<u>Challenges associated with the use of the macro assessment as a risk management tool</u>

Lack of integration of the results of macro assessments into the UNDAF results matrix and the HACT implementation plan

33. The macro assessment should be completed when the UNCT is working on the CCA. Its findings should be presented and discussed at the UNDAF prioritization retreat in order to make sure that any interventions that agencies may agree to undertake in order to address capacity gaps identified could be reflected in the UNDAF Results Matrix[19].

---

[16] Framework for Cash Transfers to Implementing Partners, page 3.
[17] Framework for Cash Transfers to Implementing Partners, page 4.
[18] Framework for Cash Transfers to Implementing Partners. Annex II, page 14.
[19] Harmonized Approach to Cash Transfers to Implementing Partners. Frequently Asked Questions, page 10.

34. However, during an online survey conducted for the global assessment involving 114 countries, it was noted that macro assessments are not being considered as one of the tools used in the CCA/UNDAF process and the HACT implementation plan, as suggested by the Framework. Only 19 per cent of the respondents noted that the findings were fully, or to a large extent, integrated into the UNDAF, with 36 per cent of respondents reporting that the macro assessment was not at all or only marginally integrated into the UNDAF. Similarly, only 29 per cent of the respondents noted that the findings were fully or to a large extent integrated into the HACT implementation plan/work plan, and 32 per cent of them reported that they were not at all or only marginally integrated.[20]

Limited use of the results of macro assessments

35. The use of the macro assessment results seems to be limited. Looking at the practicality of the macro assessment, and the fact that a large number of respondents to the global assessment survey reported that macro assessment results were not integrated in the UNDAF or HACT implementation plan, the macro assessment should also be used as first level determination on whether to adopt HACT audits and/or the need to use project audits, for obtaining the required level of assurance over cash transfers.

36. As an example, the macro assessment report for Malawi (which has been reported as HACT compliant by UNDG) highlighted a number of high risks areas, including the absence of a comprehensive set of instructions relating to the internal control framework for budget users, the absence of functioning internal audit units, poor accounting and financial reporting standards, lack of capacity of the National Audit Office, and shortage of qualified staff[21]. In situations where internal controls in the PFM system present high risk to cash transfers, project audits to obtain assurance could be necessary.

Lack of guidance for situations where a government is not willing to conduct the macro assessment or when the macro assessment is not accepted by the government

37. The Framework requires that before the harmonized procedures for cash transfers with IPs are introduced, the agencies must examine and interpret – in collaboration with national development partners – existing assessments of a country's PFM system undertaken by multilateral or bilateral development partners in the past five years. If no assessments exist and adequate data for the assessment is not available, the agencies should not themselves undertake or contract for original research for a macro assessment but advocate to the government that such work be performed[22].

38. This could be interpreted as a possibility to proceed with a HACT implementation without conducting a macro assessment or without having it cleared by the government. Such interpretation erodes the premises that (i) the government remains the owner of the process and that (ii) without a macro assessment it might not be possible to determine the capacity development needs and the risks associated with the PFM system and their utilization by IPs.

[20] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 88.
[21] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Malawi, page 6.
[22] Framework for Cash Transfers to Implementing Partners, page 5.

39. As noted in another joint HACT audit report[23], the lack of clarity in the Framework resulted in the HACT Task Force deciding to forgo the requirements for government's endorsement of the macro assessment and to progress directly to the micro assessment stage. This decision was taken after several inconclusive meetings with the concerned government, who maintained its reluctance to endorse the macro assessment. Additionally, the 2011 UNDG annual progress report shows that four other countries followed the same approach where macro assessments were not agreed with the government before the countries proceeded with the micro assessments.[24]

Lack of clear requirements as to who should perform the macro assessment

40. The Framework highlights that the review may be undertaken by staff from the agencies and other individuals agreed by the agencies or by a qualified consultant such as a reputable private accounting firm[25].

41. The macro assessment is a technically complex and intensive task, which includes the review of existing analysis and assessments, such as those conducted by the World Bank, of the national budget and development and execution process, the functioning of the public sector accounting and internal control mechanisms, audit and oversight, and financial recording systems and staff qualifications, all of which require in-depth professional expertise in public finance, financial controls and auditing that might not be within the current competencies of staff at COs.

D.1.2 Micro assessments

42. Micro assessments assist in assessing IP capacities and identifying those areas in need of strengthening. In addition, they assist in the identification of the most suitable cash transfer modalities and the related procedures and assurance activities.

43. A micro assessment should be performed for any IP (government or NGO) that is expected to receive cash transfers above an annual threshold (typically $100,000, combined from all agencies or as locally agreed among the agencies). For IPs with planned annual cash receipts below the $100,000 threshold, a micro assessment may be conducted if considered necessary by the involved agencies to determine the most effective and efficient procedures. If agencies provide cash transfers to the same IP, the micro assessment is performed jointly. When a micro assessment cannot be undertaken, the agencies should follow the procedures and assurance activities that are applicable to a high risk partner.

44. The micro assessment report is expected to provide an overall conclusion and risk rating (high, significant, moderate, low) related to the IP's financial management capacity for cash transfers; description of the financial management capacity in a selected number of subject areas;

[23] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Pakistan, page 5.
[24] The list of countries that did not obtain government agreement on the macro assessments but proceeded with the micro assessments are: Eritrea, Ethiopia, Burkina Faso and Sao Tome & Principe.
[25] Framework for Cash Transfers to Implementing Partners. Annex II, page 15.

description of the most significant risks to the receipt, recording, disbursement and reporting of cash transfers; and recommendations to the IP to address areas of risks[26].

Challenges associated with the use of the micro assessment as a risk management tool

Limited use of the micro assessments as the basis to determine the cash transfer modality, assurance activities and capacity building requirements

45. Micro assessments are supposed to be the "risk management engine" of the entire HACT process, as they provide the risk ratings to be used by the agencies to select: (i) the most appropriate cash transfer modalities, and (ii) the assurance activities to be applied as part of the cash transfer process. However, the goal of using the micro assessment as an effective risk management tool does not appear to have been met in the actual implementation of HACT to date, as evidenced by the following survey results included in the global assessment report:

a) Forty-four (44) per cent of the respondents consider that micro assessment risk ratings determine the cash transfer modality.[27]
b) Forty-five (45) per cent of the respondents consider that micro assessment risk ratings determine the assurance activities.[28]
c) Thirty-eight (38) per cent of the respondents consider that micro assessment risk ratings determine capacity building activities.[29]
d) Forty-five (45) per cent of the respondents consider that micro assessments are an effective tool to manage financial risk.[30]

46. According to the global assessment report[31], the three key challenges in using the micro assessments are:

a) Inter-agency coordination.
b) Quality of the micro assessments.
c) Managing the high volume of micro assessments.

47. Joint HACT audits also showed that inter-agency coordination within the UNCT remains one of the biggest challenges to HACT implementation. For example, one joint audit showed that while HACT guidelines require the office of the RC to establish an adequate data collection and storage mechanism/process concerning the lists of IPs; planned and actual cash transfers; transfer modality data; assessment results; and assurance plans and results; none of such data was available through that office. Records had to be accessed by auditors from individual agencies rather than from a focal point with the responsibility of maintaining consolidated records[32].

[26] Framework for Cash Transfers to Implementing Partners. Annex III, page 20.
[27] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 91.
[28] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 92.
[29] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 92.
[30] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 92.
[31] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 89.
[32] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Vietnam. Page 10.

48. Challenges regarding the quality of the micro assessments could be attributed to the selection of audit firms or consultants without the required capacities and also to ineffective inter-agency coordination, as noted in one of the joint HACT audits which evidenced that the UNCT had not established an effective and meaningful methodology and review process for establishing the quality of micro assessments[33].

49. Challenges related to managing the high volume of micro assessments appear to be a result of the large number of IPs and the assumption that agencies have a large number of shared partners. Based on the analysis of data included in the 2010 UNDG annual progress report for 36 countries reporting comprehensive IP data, only 13 per cent of the 2,648 partners reported by UNDP, UNFPA, UNICEF, and WPF were shared.

50. The lack of capacity of United Nations staff entrusted with HACT implementation was a main contributor to the challenges noted in the survey. This was reiterated during interviews with management at headquarters. The concern raised at the interviews was that, for the main part, staff such as programme officers, who do not have strong competencies for assessing risks and internal controls, are being entrusted with this work.

Lack of clear guidance on the thresholds related to micro assessments

51. In accordance with the Framework, agencies should conduct a micro assessment of any IP expecting to receive combined (from all agencies) cash transfers in excess of $100,000 or other threshold locally agreed among the agencies. Delegating the threshold amount definition to the agencies could result in inconsistencies among different countries.

52. The joint HACT audit for Vietnam noted that the micro assessment threshold was established at $500,000, five times the amount recommended in the Framework. As a result, this decision effectively halved the number of micro assessments that would have been conducted for one of the agencies – UNFPA – based on the $100,000 threshold defined in the Framework[34].

Lack of clear guidance on the risk ratings related to micro assessments

53. The Framework lacks clear guidance to ensure consistency in the risk rating of IPs. Such consistency is of the utmost important to the HACT process, as risk ratings are the key driver for the type of cash transfer modality to be used and the type, scope and frequency of assurance activities to be performed. Without such guidance, there is a high risk that ratings will not be consistent across countries and the assurance derived from the system would be insufficient.

[33] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Indonesia. Page 5.
[34] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Vietnam, page 7.

Lack of clear guidance as to who should perform the micro assessments

54. The Framework highlights that micro assessment may be undertaken by staff from the agencies or by qualified consultants such as a reputable and experienced private accounting firm contracted by the agencies, and that, ideally, "*the assessment team should be led by a person experienced in assessing control frameworks and risk, in particular the application of the IFAC International Standard on Auditing 400 'Risk Assessment and Internal Control*"[35].

55. A micro assessment is a highly technical activity. Performing an effective risk assessment requires a strong understanding of finance, financial processes, internal controls and auditing, which might not be within the current competencies of staff at COs.

D.1.3 Cash transfers

56. The Framework highlights the four cash transfer modalities available to the agencies:

a) Direct cash transfer.
b) Direct payment.
c) Reimbursement.
d) Direct agency implementation.

57. According to the Framework, it is desirable that agencies agree on a preferred common modality for each IP, but each agency may choose the most appropriate modality for specific programmes and IPs. The basic elements of the cash transfer procedures cover the following areas:

a) Basis for disbursements
- The basis for cash transfers are the activities to be carried out by IPs as described in the corresponding Annual Work Plans (AWPs).
- IPs should submit requests to the agencies for release of funds or for agreement that the agencies will reimburse or directly pay for planned expenditures. These requests should be made through the use of FACE forms.

b) Periodicity of disbursements
- Direct cash transfers are expected to be requested and released for programme implementation periods not exceeding three months.
- Reimbursements for previously authorized expenditures are expected to be requested and released quarterly or after completion of activities.

c) Reporting on cash utilization
- IPs should use the FACE form to report on the utilization of cash received, or to request reimbursement for expenditures already incurred.
- The same FACE form is used for requesting new transfers, or requesting authorization to incur future expenditures (for reimbursement or direct payment to vendors).

[35] Framework for Cash Transfers to Implementing Partners. Annex III, page 22.

- Cash disbursed but not utilized by IPs may be re-programmed by mutual agreement if it is consistent with the purpose and timeframe of the funding source, or may be refunded[36].

58. The cash transfer procedures seem to be the most accepted and consistently utilized mechanism of the Framework. Exceptions noted do not appear to be detrimental to the process.

D.1.4 Assurance plans and activities

59. According to the Framework, the purpose of assurance activities is to determine whether the funds transferred were used by the IPs for the appropriate purpose, and in accordance with the stipulated procedures[37]. The scope of assurance activities required by the agencies is guided by the risk ratings assigned to the IPs and the amount of the cash transfers paid by the agencies[38]. The specific combination, frequency and scope of assurance activities for each IP will be determined by the Representatives of the agencies. The strongest assurance activities should be directed to those IPs with the weakest financial management practices[39].

60. There are three mechanisms through which agencies obtain assurance that the funds provided to IPs were received, expensed, and reported following the IPs' system of internal controls for activities agreed with the agencies:

- Periodic on-site reviews of IPs' financial records for cash transfers.
- Programmatic assurance of the implementation of supported activities.
- Scheduled audits of IPs' internal controls for the management of cash transfers.

Periodic on-site reviews of IPs' financial records for cash transfers

61. On-site reviews undertaken by agency staff or external consultants acting on their behalf include "spot-checks" and "special audits". The spot checks assess the soundness of the internal controls and the accuracy of the financial records for cash transfers maintained by the IPs. A spot check is not an audit. When agencies support the same IP in the same location, joint spot checks should be conducted. Alternatively, one agency can authorize another agency to conduct spot checks on its behalf.

62. Agencies are advised to perform at least one spot-check related to cash transfers per IP per year. If significant weaknesses are identified during the spot check, agencies may decide to increase the scope and frequency of future spot checks or assess whether a special audit is required.

63. Spot checks include a number of audit steps such as reconciliations and interviews, mainly to confirm the reasonableness (i.e., validity) of a sample of expenditures recorded in the FACE forms. In addition, agencies attempt to confirm the reasonableness (i.e., effectiveness) of the internal controls in place by testing a sample of disbursement transactions. One step of the

[36] Framework for Cash Transfers to Implementing Partners, page 7.
[37] Framework for Cash Transfers to Implementing Partners. Annex IV, page 35.
[38] Framework for Cash Transfers to Implementing Partners, page 7.
[39] Framework for Cash Transfers to Implementing Partners. Annex IV, page 35.

identified tasks is to review the adequacy of supporting documentation to ensure that transactions are consistent with their description (per the accounting records) and with the activities described in the AWPs.

64. Spot check reports are expected to contain a summary of the findings, with the indication of risks; a list of transactions tested; and related recommendations to the IP [40.] .

Programmatic assurance of the implementation of supported activities

65. Per the Framework, *"programmatic* assurance *is maintained following standards and guidance established by each agency and includes receipt of implementation reports from IPs, site visits by agency staff, annual reviews, and evaluations."*[41]

Scheduled audits of IPs' internal controls for the management of cash transfers

66. Scheduled audits are used to assess the existence and functioning of IPs' internal controls over the receipt, recording and disbursement of cash transfers and the fairness of a sample of expenditures reported in the FACE forms. It is not expected that testing of samples will provide assurance over individual FACE forms[42] .

67. For each IP, audits should be scheduled at least once during the programme cycle if combined (by all agencies) cash transfers are expected to exceed $500,000 during the period covered by the CPAP, or for IPs who are expected to receive less than $500,000 if considered necessary by one or more agency. Agencies are expected to use the SAI to undertake the audits of the IP if the macro assessment establishes that the SAI has adequate capacity[43].

Challenges associated with assurance activities

Inappropriate consideration of assurance activities within the HACT compliance criteria

68. HACT compliance criteria only consider whether assurance and audit plans are in place, regardless of whether planned assurance activities have been effectively implemented. In order to ensure the achievement of the HACT objective of providing appropriate assurance about the use of funds for intended purposes, the HACT compliance criteria should be enhanced to include the sufficiency and quality of actual assurance activities performed. In addition, a coordinated mechanism at headquarters should be charged with selectively reviewing assurance reports, including spot checks, for quality and consistency with the Framework before a country is deemed to be HACT compliant.

Lack of quantification of assurance levels obtained

69. Conceptually, the combination of the three assurance mechanisms -scheduled audits, spot checks and programmatic assurance- could provide adequate assurance as to whether the funds transferred were used for the appropriate purpose, and in accordance with the stipulated

[40] Framework for Cash Transfers to Implementing Partners. Technical Note 6, page 66.
[41] Framework for Cash Transfers to Implementing Partners. Annex IV, page 36.
[42] Framework for Cash Transfers to Implementing Partners. Technical Note 4, page 60.
[43] Framework for Cash Transfers to Implementing Partners, page 8.

procedures[44]. However, the mechanisms as presented in the Framework, fail to provide assurance as to whether the funds transferred were used for the appropriate purpose, and in accordance with the stipulated procedures. In addition, the level of assurance required for financial reporting purposes to be obtained through the three assurance mechanisms has not been discussed and agreed upon with the UN BoA, a key stakeholder of HACT.

70. Spot checks reporting guidelines do not require any sort of opinion or conclusions, while the audit reporting guidelines require an opinion that is focused only on the functioning of internal controls[45]. Hence, reports for both types of assurance activities may not provide an acceptable measure as to whether the funds transferred were used for the appropriate purpose, and in accordance with the stipulated procedures.

Lack of capacity to perform the spot checks

71. According to the Framework, spot checks can be performed by agency staff or by a representative of the agencies. During the joint HACT audits performed it was noted that, in the limited number of situations where spot checks had taken place, these had been performed by United Nations staff. While the Framework should be clearer on who should actually perform these reviews, the main question is whether the United Nations staff has the capacity to perform them.

72. According to the global assessment report, the majority of countries implementing HACT voiced their challenges in ensuring regular spot checks for government and non-government IPs. United Nations agencies in countries with a large number of IPs are overwhelmed by the capacity needed to complete the spot checks and other assurance activities. Site visits may require several days of travel to remote areas, resulting in the absence of staff members from the office for extended time periods. In addition to the time constraints and the limited amount of available staff at the country level, many countries commented that their staff members do not have the capacity to conduct reviews aimed at verifying internal controls and financial transactions. The possibility of outsourcing spot checks and other assurance activities to audit or consulting firms was not seen as a realistic option by many countries because of its cost[46].

Lack of guidance on thresholds, frequencies and sample sizes

73. Thresholds, frequencies, and sample sizes are essential to the Framework as they are important elements for micro assessments and the different types of assurance activities. However, the Framework either provides little guidance on such elements or delegates the responsibility of determining the guidance to the UNCT, increasing the risk of an inconsistent interpretation of the procedures between the different countries and hence diminishing the level of assurance provided as part of the HACT process.

[46] Global Assessment of the Harmonized Approach to Cash Transfers (HACT), page 56.

74. In particular, the current framework lacks precise guidance on thresholds and sample sizes[47]:

a) Micro-assessment: The Framework requires UNCTs to micro-assess partners that receive or are expected to receive cash transfers above an annual amount (usually $100,000 combined from all agencies; as initially defined in the CPAP or AWPs or as locally agreed among the agencies). For IPs with planned annual cash receipts below the $100,000 threshold, assessments may be conducted *if considered necessary* by the involved agencies to determine the most effective and efficient procedures.

b) Scheduled audits: The Framework requires UNCTs to conduct scheduled audits of IPs' financial management systems at least once during the programme cycle if more than $500,000 in cash transfers is expected to be disbursed collectively by the agencies during the period covered by the CPAPs, or for IPs who receive less than $500,000 *if considered necessary* by one or more agency.

c) Spot-checks: The Framework highlights that it is *advisable* that at least one spot-check related to cash transfers per IP per year be conducted. If significant weaknesses are identified during the spot check, agencies *may decide* to increase the scope and frequency of future spot checks or whether a special audit is required. Similarly, for IPs with an overall micro-assessment risk level of "moderate" or higher, *several* spot checks (e.g. quarterly) may be conducted per year.

d) Review of sample of expenditures: The Framework identifies that as part of spot checks, testers should include a review of a sample of expenditures recorded in the FACE reports issued during the period under review as well as a review of a sample of disbursements, with specific procedures such as the assessment of the adequacy of supporting documentation (e.g. invoices, purchase orders, etc.) to ensure that it is consistent with the description of the transaction (per the accounting records) and with the activity described in the AWP. Yet the Framework does not provide guidance on which sampling procedure is adequate.

75. The lack of sufficient guidance on thresholds, frequencies and sample sizes to UNCT increases the risk of inconsistent interpretation of the procedures between the countries and a decrease in the assurance provided as part by the process. For example, during the audit of Vietnam, it was noted that the UNCT had significantly increased the threshold for micro assessment by fivefold from the recommended threshold of $100,000 to $500,000, while the threshold for special audits was increased from the required threshold of $500,000 to $1 million[48]. Furthermore, while the Framework recommends quarterly spot checks for IPs with risk ratings of "moderate" or higher, the Vietnam team conducted only two spot checks, disregarding the Framework's guidance.

[47] Emphasis added in italics for a, b and c.

[48] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Vietnam, page 5.

D.2. HACT as a Cost Reduction Tool

76. While the reduction of transaction costs has been one of HACT's primary objectives, there is no evidence that the adoption of HACT has led to a reduction of costs for United Nations agencies.

77. During interviews, management at UNICEF, UNDP and UNFPA headquarters stated their belief that the main reduction in transaction costs will be realized by reducing the number of project audits performed as a result of using HACT's risk management approach, and by sharing of the cost of capacity assessments and assurance activities for common IPs.

78. The likelihood that HACT would lead to a significant reduction of transaction costs is diminished because (i) participating United Nations agencies within a country actually have a limited number of shared IPs, approximately 13 per cent (see details in Annex 5), and (ii) HACT results in a number of additional costly activities such as macro and micro assessments, spot checks and other assurance activities. While it is acknowledged that capacity assessments and spot checks should be performed as a good practice regardless of whether or not HACT is implemented, under the current NIM/NEX audit process, reliance on such activities is limited because assurance is obtained primarily through the annual project audits.

79. It was noted that, to date, a detailed analysis validating the actual achievement of cost saving has not been performed by either UNDG or any of the HACT participating agencies. Yet, as shown in Annex 6, the total combined cost of NIM/NEX audits incurred by UNDP and UNFPA amounted to $10.7 million.

D.3 HACT as a Simplification and Harmonization Tool

80. The Framework has introduced many elements related to the simplification and harmonization of rules and procedures, mainly in the areas of: (i) capacity assessments, through joint macro and micro assessments; (ii) audits and spot checks; and (iii) cash distribution and IP expenditure reporting, through the use of common FACE forms.

81. Based on the 2010 UNDG annual progress report, the change in the method of cash distribution through the use of FACE forms and the abandonment of the expense verification process seems to be the most prevalent harmonization and simplification benefit of HACT; 85 per cent of countries are using FACE forms consistently. This is followed by the macro and micro assessments, which the 2011 UNDG annual progress report shows, have been performed by 69 per cent and 47 per cent of the countries respectively, while harmonized audits, spot checks and other assurance activities have not been reported on[49].

82. Over 21 countries reported harmonization to be one of the main challenges to HACT implementation. For example, Uganda, Honduras, Mozambique and Sierra Leone all noted difficulties in planning and performing joint assurance activities. Malawi reported that policies and guidelines from the participating agencies headquarters are different, imposing an additional constraint on undertaking harmonized actions at the local level. The Democratic Republic of the

[49] The 2011 UNDG annual progress report did not provide information on the use of the FACE forms.

Congo reported challenges posed by agencies' headquarters, particularly as regards to the move to HACT IP audits.

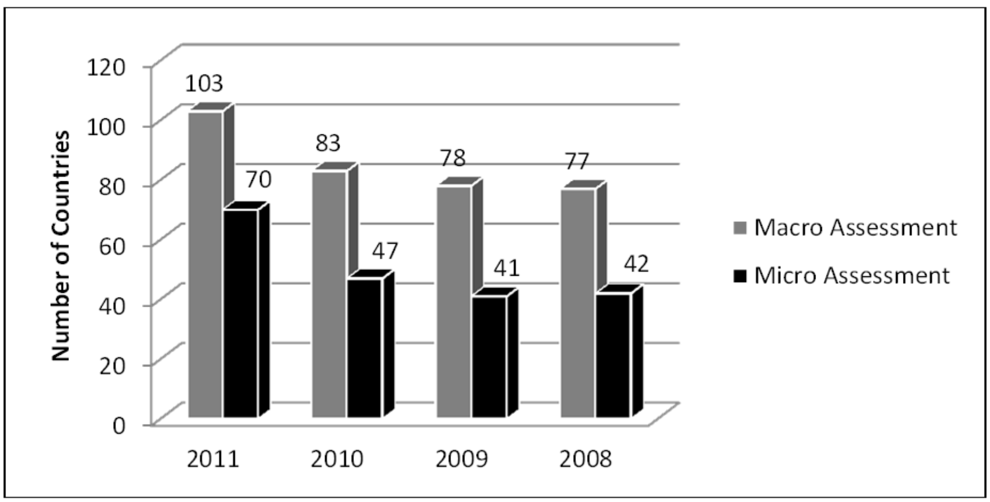
83. Hence, while the Framework seems conceptually a good approach to simplify and harmonize procedures, its actual implementation is dependent on the successful harmonization of related business practices and a high level of coordination between the agencies, both of which seem to have only partially been achieved.

D.4 HACT as a National Capacity Development Tool

84. Capacity development is one of the main objectives of HACT. However, the Framework provides limited guidance on the capacity development process, which according to UNDP, includes the following elements: (i) Engage stakeholders on capacity development; (ii) Assess capacity assets and needs; (iii) Formulate a capacity development response; (iv) Implement a capacity development response, and (v) Evaluate capacity development[50].

85. The Framework has been successful in introducing two mechanisms that should operate within the capacity development process noted above – namely macro (assessment of a Country's Public Financial Management System) and micro (assessment of the Financial Management Capacity of Implementing Partners) assessments which allow UNCTs to engage stakeholders on capacity development and assess capacity and needs. However, there is no guidance in place relating to the formulation of a capacity development response, implementation of a capacity development response and the evaluation of capacity development.

Figure 5 - Countries that have performed capacity assessments



Source: 2011 UNDG annual progress report

86. As shown in *Figure 5* above, only 70, or 47 per cent of the 150 countries surveyed, have met two (engage stakeholders and assess capacity assets and needs) of the five elements of the capacity development process by performing IP micro assessments. For these 70 countries, it

[50] UNDP includes capacity development as one of its key mandates. See UNDP website for further information, at http://www.beta.undp.org/undp/en/home/ourwork/capacitybuilding/approach.html#

was not possible to assess whether UNCTs have formulated appropriate capacity development plans, implemented such plans and evaluated the capacities developed, as:

a) The Framework does not include capacity development plan formulation, implementation and evaluation as part of the HACT implementation criteria.
b) Neither UNDG nor the agencies monitoring HACT implementation require reporting over any of these 3 elements for purposes of assessing HACT compliance.

87. As stated by the Committee, capacity development is a central part of HACT and of the work of any United Nations agency. Without actions to address capacity gaps identified, risk management is virtually limited to risk assessment [51] and might not provide sustainable benefits over time.

E. HACT Governance

E.1 Accountability, Roles and Responsibilities

88. Overall accountability for a successful implementation of HACT is not clearly defined, accepted, documented, and communicated. In fact, there is confusion over who has overall accountability over HACT implementation.

89. Roles and responsibilities over HACT identified based on discussions with UNDG are summarized in *Table 3* below. It should be noted that this breakdown in roles and responsibilities is neither documented in the Framework nor communicated.

Table 3 - HACT roles and responsibilities at the global and regional levels

Unit	Activity
UNDOCO	▪ HACT coordination and support
HACT Advisory Committee	▪ Inter-agency policy and technical guidance and support
Individual agencies headquarters	▪ Agency guidance
Regional Directors - regional agency focal points & coordination officers	▪ Oversight, monitoring and support ▪ Inter-agency policy and technical guidance and support

Source: UNDG discussions with audit team

90. Aside from the overall accountability for HACT, other roles and responsibilities at the regional and headquarters levels are also not clearly defined and documented. While some stakeholders consulted during the engagement are of the view that the RC has overall responsibility for HACT implementation, other stakeholders view the agencies' CO Representatives as having that responsibility. Consulted stakeholders argued that while RCs may have coordination responsibilities, they are not however empowered to ensure that specific agencies within their respective countries are committed to HACT and therefore, accountability

[51] HACT – Responses to Key Implementation Challenges, page 5.

rests with each agency's CO Representative and their respective accountability which resides ultimately with the management of the agencies.

91. Accepting the premise that RO Directors and CO Representatives have some degree of accountability for HACT implementation, there would be an expectation that HACT would have been reflected in their performance planning and appraisals. However, upon review of the performance plans and appraisals of the top (by expenditure) UNFPA CO Representatives and five RO Directors, it was noted that they did not include any planned outputs, activities and indicators related to HACT[52].

92. Lack of clarity on HACT related roles and responsibilities at the regional and headquarters levels may have contributed to the complexity of the HACT process and the lack of implementation at the country level. For example, while *Table 3* shows that individual agencies' headquarters are only expected to provide agency guidance, UNDP and UNFPA HQ units perform oversight and monitoring of HACT implementation, a role that, according to UNDG and as reflected in the previous page, is the responsibility of the Regional Directors. Further compounding this issue is the absence of clear responsibilities for analysis of data from UNDG, identification of challenges faced by countries and in a coordinated effort by all agencies, the ability to reach agreement on the next steps needed to alleviate such challenges.

93. The Framework briefly covers roles and responsibilities with regards to technical assistance and inter-agency support; however, the Framework is outdated as the groups or agencies' staff named to provide the support either no longer exist or are not in their current roles. For example, the Framework identifies one UNDP audit technical support focal point that has left the agency over three years ago.

E.2. Inter-Agency Coordination – HACT Advisory Committee

94. Inter-Agency coordination of HACT is performed through the UNDG's HACT AC. The HACT AC role is essential as an inter-agency coordination function within the implementation of HACT. The approved HACT AC Terms of Reference (TOR) define its role and objectives but do not provide specifications about the outputs and activities associated with the achievement of the stated objectives (the global assessment of HACT commissioned in June 2011 is intended to guide the activities of the HACT AC in 2012).

95. While the Chair of the HACT AC is expected to be appointed on a rotational and elected basis, during our interviews it was highlighted that the current Chair was invited to lead the HACT AC directly by the Director of UNDOCO, rather than selected through an election process. This direct method was used as there was a lack of interested candidates to chair the HACT AC, a role that is demanding but lacks recognition.

96. In addition, while the HACT AC is expected to be comprised of members representing the programme, finance and audit departments of the participating agencies, based on our review

[52] The Regional Office Directors and Country Office Representative tested are: Africa, Asia, Latin America, Arab States, Eastern Europe and Central Asia, Afghanistan, Bangladesh, DRC, Ethiopia, India, Nigeria, Pakistan, Sudan, Tanzania and Uganda.

of the current membership, we noted: (i) lack of complete representation by some agencies; (ii) lack of representation of senior management empowered to take decisions on behalf of their agencies; (iii) lack of representation by finance and audit units; as well as (iv) high representation of programme staff. The membership list shows the following:

a) Three agencies that are implementing HACT in at least one country (namely Tanzania) are not represented on the Committee (ILO, UNAIDS and WFP).
b) Four agencies are represented by only one member representing one function rather than the three (Programme, Finance and Audit) identified in the TOR (UNESCO, UNFPA, UNHCR and UNIDO).
c) Strong representation by programme staff and lack of representation by finance and audit (this was especially noted for UNDP, UNFPA and UNICEF).

97. The lack of clarity on HACT related roles and responsibilities mentioned above, was further evident during the completion of this audit report. The draft audit report was issued in January 2012 to the HACT Advisory Committee, which is viewed as the main mechanism to provide policy advice and coordinate with the management of the agencies to implement the report's recommendations. In its answer on March 2012, the HACT Advisory Committee replied that the recommendations should be addressed to the management of agencies. This hence minimizes their role within the HACT management process and further evidences the need for a robust accountability framework for the HACT process.

F. HACT Monitoring and Verification

F.1 Monitoring of HACT Implementation on an UNCT basis

98. Monitoring of HACT implementation on an UNCT basis is currently performed through UNDG's annual progress report. This monitoring is based on self-reporting by the RCs and is conducted through the Regional Coordination Specialist network. The update is segmented by region and country, reports details on the HACT implementation progress level for the country, and provides countries the opportunity to comment on the challenges faced in their implementation of HACT. This monitoring tool is critically important as it is the only one performed at the UNCT level, providing a reasonable level of information for monitoring purposes.

99. The major shortcoming of this monitoring process is that it is based solely on self-reported data; the information provided is not verified for accuracy or consistency before it is reported to stakeholders. The lack of verification is the main cause for the discrepancies in HACT compliance figures reported by UNDG, UNDP, UNFPA and UNICEF.

100. In addition, while the UNDG reporting tool provides sufficient information to recognize trends and identify challenges, it does not seem to be used for assessing progress on HACT implementation and decide on remedial actions, as needed.

F. 2 Monitoring of HACT Implementation on an Agency basis

101. In addition to the monitoring performed by UNDG, as discussed above, HACT implementation is also monitored by UNDP, UNFPA and UNICEF. As explained in the following sections, such monitoring is done by different units within each organization.

F.2.1 Monitoring of HACT Implementation at UNICEF

102. At UNICEF, the monitoring of HACT implementation is performed by the Office of United Nations and Inter-Governmental Affairs within the Programme Division. The monitoring is performed through the CO annual reports, produced at the year-end and submitted by 10 January of the following year. The monitoring tool allows COs to report on each step of the HACT implementation criteria in addition to their overall HACT compliance status. The report also provides COs the opportunity to provide additional comments as needed.

103. While the reporting mechanism is useful, there is no process to verify the information reported, raising concerns with regards to its accuracy. Our review identified 24 COs (out of a total of 60) reported to be HACT compliant although they did not have a joint audit and assurance plan in place, a key criteria of HACT compliance.

F.2.2 Monitoring of HACT Implementation at UNDP

104. At UNDP, HACT implementation monitoring is conducted by OFA. The OFA reports 61 HACT-compliant COs, based on self-reporting by COs without any verification of the data provided. Furthermore, OAI reports that only six COs[53] have implemented and have applied HACT audits; OAI's figures are based on a process that must document that the following six criteria have been fully satisfied:

a) A macro-assessment has been duly completed or, if not completed, high risk has been assumed.
b) A 100% micro-assessment has been duly completed or, in exceptional situations where a micro-assessment could not be completed for an IP, high risk has been assumed.
c) There is a documented mutual agreement on the implementation of HACT with the government, either in the CPAP or through the exchange of letters. Both the government and UNDP officials must sign these documents.
d) A joint audit and assurance plan of IPs has been properly developed and implementation mechanisms agreed upon and signed by the Representatives of the individual agencies.
e) A signed letter from the RC along with the Representatives of the individual agencies certifies that all the steps indicated above are complete; and
f) A written communication from the RC confirms that HACT has been fully implemented by the UNDP CO for the 12 months of the previous fiscal year,

[53] At the time of audit field work.

indicating that the HACT audit approach will be implemented in lieu of the NGO/NIM audit approach.

105. COs that satisfy the above six criteria are required to upload all the necessary supporting documents for each of the six criteria in the *Comprehensive Audit Recommendations Database System* (CARDS) in February of each year. The supporting documents are reviewed by OAI and, if found adequate, the CO is authorized to substitute the NGO/NIM audit process with the HACT audit approach. COs that qualify for implementing the HACT audit approach are required to adhere to the HACT audit plan and submit the related reports to OAI within three months of the audit start date indicated in the plan. These audit reports are reviewed by OAI and retained for future reference. OAI provides the COs with comments on the outcome of the audits.

F.2.3 Monitoring of HACT Implementation at UNFPA

106. At UNFPA, HACT implementation monitoring includes a verification mechanism that is performed by the NEX unit, part of DMS, which has assessed nine COs as HACT compliant. As is the case of UNDP, UNFPA also relies on the COs to report their HACT compliance status, which is verified by the NEX Unit by reference to five compliance criteria, similar to those used by UNDP, except that UNFPA does not require a written communication confirming that HACT has been implemented by the CO for the 12 months of the previous fiscal year. Documents supporting the five criteria are uploaded by the COs in the *National Execution Audit Management System (NEXAMS)* at the time audit plans are prepared. HACT compliance then takes into account the information submitted by the office in their audit plan.

107. The comparative analysis of the monitoring processes at the three agencies discussed above confirms that all of them perform some type of monitoring; however, based on our review we noted the following:

a) Monitoring and verification of HACT compliance status is performed inconsistently, specifically when comparing UNFPA and UNDP to UNICEF and UNDG.
b) UNICEF relies on self-reporting of the implementation status by their COs, without any verification of the accuracy or validity of the reported status.
c) UNDP and UNFPA rely on implementation status information provided by their COs; however, they verify the status reported by their COs.
d) While it is encouraging to note that a verification process at UNDP and UNFPA is in place, it is pertinent to note that such verification process is not sufficient as it does not include ensuring the following:
    - Risk assessments have been properly performed and risk levels have been appropriately assigned for IPs.
    - Audit and assurance plans are complete and accurate.
    - Audit activities – scheduled and special audits and spot checks - have in fact been implemented and are in line with the Framework and the audit and assurance plan, and the results of such assurance activities are reflected in the updated assurance plans.

G. HACT Compliance Criteria

G.1 What is HACT compliance and who certifies compliance

108. According to the HACT Committee, a country can be considered HACT compliant when:

e) A macro assessment has been completed or high risk has been assumed.

f) All IPs receiving annual advances from participating agencies in excess of $100,000 (or any other threshold set by the agencies at the country level) have been micro assessed, or high risk has been assumed for the IPs for which micro assessment could not be completed.

g) There is agreement on HACT implementation with the government either in the CPAP or through an exchange of letters.

a) A joint assurance and audit plan of IPs has been developed and implementation mechanisms agreed upon.

109. Since HACT is a harmonized approach amongst all agencies in a country, if any of them do not consider that the above criteria have been met, the country should not be considered HACT compliant. Furthermore, the RC, along with Representatives of the individual agencies, should certify that the above steps are complete and that the UNCT is HACT compliant. The RC should also inform the relevant Regional Directors' Team (with a copy to the Development Operations Coordination Office) once the UNCT has been assessed as HACT compliant[54].

110. The compliance criteria and who has authority to certify compliance are not clearly defined in the Framework. The compliance criteria have instead been communicated by the HACT Committee through a "Responses to Key Implementation Challenges" document, but it remains unclear who has the authority to certify compliance. This has led to the confusion at COs on what constitutes HACT compliance and who has the authority to certify compliance. Such confusion was noted in the joint Indonesia HACT audit[55] This also may be the cause for inaccuracies noted in the 2011 UNDG annual progress report which, as an example, reported that two countries (out of 29) had been assessed to be HACT compliant although they did not have a joint audit and assurance plan in place, or that ten countries, or 34 per cent, had been assessed to be HACT compliant although WFP, one of the agencies, was not participating in HACT – two of the main criteria for HACT compliance[56] [57].

[54] HACT Advisory Committee. HACT Responses to Key Implementation Challenges, page 6.

[55] Joint Audit of the Harmonized Approach to Cash Transfers (HACT) in Indonesia, page 6.

[56] The two countries that reported to be HACT compliant but did not have an audit and an assurance plan in lace are: Guatemala and Surinam.

[57] The 10 countries that reported to be HACT compliant while WFP is not active participant of HACT implementation are: Botswana, Guinea-Bissau, Kosovo, Uruguay, Surinam, Guatemala, Indonesia, Lao, Malaysia and Thailand.

G.2 Appropriateness of the HACT Compliance Criteria

111. The HACT compliance criteria noted by the HACT Committee are simply guiding criteria, the achievement of which should not be construed as ensuring compliance without actual evidence of their appropriate use and implementation of the related tools.

112. Given that HACT is viewed as a risk management mechanism, other key main elements missing include the following aspects:

- *The assessment of the appropriateness of the risk ratings assigned to the implementing partners*.

  The method for assigning risk ratings should be consistent across countries as risk levels affect the entire HACT process; however, given that micro assessments are conducted by different consultants across the globe, and with the lack of sufficient guidance on how to assign risk ratings, there is a high inherent risk that these will not be consistent. While the Framework provides two checklists, labeled as A and B, as guidance for micro assessments, it does not provide any detailed guidance on how to assign "low", "medium" or "high" risk ratings.

- *The assessment of the appropriate selection of the type of cash transfer modality and the appropriate level of assurance activities commensurate with the risk levels assigned to implementing partners*.

  Once a risk assessment is complete and a risk rating is assigned, the CO will have to apply a cash transfer modality and assurance activities commensurate with the risk rating. The selection of an appropriate cash transfer modality and assurance activities is key to the risk management process; however, such selection is not currently verified and without such verification, there would be no assurance of the appropriateness and consistency of the process. We noted inconsistencies, during two joint audits, in the manner in which different countries react to the risk levels assigned to IPs. In Malawi, the agencies resorted to the use of reimbursements or direct payment to vendors' method for IPs assessed as high risk, in lieu of cash transfers to the IPs. In Vietnam, the participating agencies simply resorted to increasing the number of spot checks from one to two spot checks per year for IPs assessed as high risk. As it can be noted, two different approaches were used, as the Framework does not have clear guidance on how to consistently deal with the different risk levels identified.

- *The confirmation of implementation of the assurance activities identified in the assurance plan*.

  The four HACT criteria currently in place require that assurance plans be in place. While such requirement is important, the criteria should also include the confirmation that such plans have been implemented. In the absence of confirmation that the assurance activities have been executed and their results analyzed, no real risk assessment has been achieved. This was clearly noted during the HACT audits of Vietnam and Malawi. We noted that while both countries may have fulfilled the HACT compliance criteria, including the preparation of audit plans, and were designated as HACT compliant by UNDG, the audit plans were not accurately implemented, as was the case in Malawi, or only partially implemented, as was the case in Vietnam. HACT compliance designation should not be granted and the reliance on HACT for risk management should not take place until actual assurance activities, such as scheduled and special audits as well as spot checks, are implemented and their results appropriately taken into consideration in further assessing the risks associated with the IPs.

H. Conclusion and Recommendation

113. In conclusion, the audit revealed the need to fundamentally revisit the framework and address the challenges mentioned throughout this report. In view of the lack of ownership mentioned earlier, the overall recommendation is addressed to the Chair of the UNDG.

> ***Recommendation 1 (High/Critical) –*** *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 either to redesign it as appropriate, ensuring that the issues identified by the joint audit 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 and more effective policy or approach that would achieve the same objectives intended by the HACT Framework, while encompassing the points raised in this report.*

114. The framework resulting from the decision above, either a revised HACT or a new framework should exhibit enhanced efficiency and effectiveness and be more implementable than the present one. Ultimately, it should contribute to a better level of assurance on operational and financial reporting.

115. In particular, the instruments, i.e. macro-assessment, micro-assessment and joint assurance and audit plan, should be thoroughly reviewed, both design and implementation. They should be modified where necessary, so that they are implementable and systematically implemented, as well as integrated with the UNDAF as well as with the UNCT risk management. To ensure a consistent implementation process, the revised or new framework needs to include specific guidance on parameters like thresholds, frequency of assurance activities and sample size.

116. The roles, responsibilities of the HACT AC (or any new equivalent body in a new framework), RCs, UNCTs and Country and Regional Directors regarding the Framework, as well as the articulation of these various entities vis-à-vis one another and their respective decision power, should be clearly spelled out and endorsed at the most appropriate inter-agency level, e.g. the Chief Executives Board. The documentation should be comprehensive and contribute to a clearly articulated and communicated accountability Framework encompassing all levels of the organizations – headquarters, regional and country offices. The composition of the HACT AC (or any new equivalent body) should also include equal membership of all functions

and be comprised of senior level management empowered to make and approve decisions on behalf of their divisions and agencies. To preserve objectivity, however, the audit function should be represented only as observer.

117. Monitoring and verification activities should be performed in a coordinated manner between UNDG and all the Framework participating agencies; a consistent approach should be discussed and coordinated at the HACT AC (or new equivalent body), being agreed upon between UNDG and participating organizations. In particular, verification of data and information reported by countries and country offices should be harmonized and reliable.

118. Compliance criteria, like (i) the assessment of the appropriateness of the risk levels assigned to IPs, (ii) the assessment of the appropriate selection of type of cash transfer modality and of appropriate assurance activities commensurate with the risk levels assigned to IPs, or (iii) the confirmation of execution of the assurance activities identified in the assurance plan and assessment of their results, should also be standardized across all participating organizations.

119. Further, the application of compliance criteria, and therefore the determination of Framework compliance status, should also be harmonized, allowing for better comparability and reliability. Ultimately, there should be a formal representation of compliance signed by the senior management of all participating organizations (e.g. controllers).

120. All those involved in the framework should be held accountable for its timely and successful implementation, by ensuring performance plans and appraisals include framework-related outputs and indicators.

121. In addition, a cost baseline should be set up, to serve as a base to identify cost reduction, if any. The cost impact of any change in level of assurance obtained through project audit processes should be taken into account when comparing costs.

Management Comments

122. The Director of UNDOCO provided comments on the re-drafted report, based on the input of the Chair of the HACT AC (included in full in Annex 1).

123. Management questioned the purpose and methodology of the audit report (imbalanced manner in which holistic objectives of HACT were looked into, source of data limited to responses to a questionnaire). It is recalled that the audit objective, i.e. to assess whether the governance arrangements in place were adequate to support an effective implementation of HACT objectives, together with the multiple sources of data and information used are clearly spelled out in Section A of this report.

124. While management 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 (only advisory, without any monitoring role), 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 a source of sub-performance).

125. Notwithstanding the above, management indicated that it is considering revising the HACT Framework.

126. The Internal Audit Services of UNDP and UNFPA take note of dissenting views; however, given the analytical work undertaken in the course of this audit, 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. The Internal Audit Services of UNDP and UNFPA welcome the indication that management considers revising the HACT Framework and look forward to its prompt implementation.

Annex 1: Management Comments

Management answer received from the Director, UN Development Operations Coordination Office on 18 October 2012

Thanking for sharing the Joint Audit of Governance Arrangements for the Harmonized Approach to Cash Transfers draft report and for the extension of the original deadline, the Director indicated that "[i]n order to enable DOCO to prepare an informed response, the draft report was shared with the HACT AC Chair. Following that consultation, [the Director, DOCO was] pleased to share with you the HACT AC feedback which DOCO supports."

The message from the HACT AC Chair followed. Indications from the audit team follow.

"Thank you for sharing the draft audit report and providing the opportunity for the HACT AC to comment on it. Without repeating HACT AC comments on earlier draft (herewith attached for easy reference), it is noted that that all recommendations are now folded into one. I [HACT AC Chair] am also pleased to share with you [Director, DOCO] some additional comments received:

- As stated in para. 3 of the draft audit report, HACT was launched as a step towards the implementation of UN General Assembly Resolution 56/201 which calls for the simplification and harmonization of rules and procedures in the UN system. It also aimed to ensure a shift from project-based ex-post controls to assurance based ex-ante system of risk management. In addition HACT was designed to contribute to a reduction of transaction costs and strengthened national capacities for management and accountability of programme countries as stated in the Rome Declaration on Harmonization and Paris Declaration on Aid Effectiveness. The draft audit report seems to emphasize the financial management and risk control elements of HACT for UN agencies but does not address other equally important dimensions of HACT's objectives. Out of the 43 pages, only 3 pages (sections D.2 through D.4, pages 27-29) are devoted to the topics of cost reduction, simplification and harmonization. As such, the draft report does not assess the holistic objectives of HACT in a balanced manner.
- A major part of the analysis contained in the report is based on responses to questionnaires provided to Country Offices. The draft audit report may thus be strengthened if additional empirical evidence is provided to support the audit findings.
- With respect to the role of the HACT Advisory Committee, a lack of clarity on its role was cited. The HACT Advisory Committee by design, was not meant to be an overall monitoring/oversight body, but one responsible for coordination, technical guidance and support. While it is true that the respective roles of the HACT Advisory Committee, RDTs, and the respective UNCTs can and should be clarified and strengthened, the ultimate responsibility for HACT implementation resides with the local UNCTs which implements HACT on the basis of the local country context.

- Closely related to the previous point, the HACT AC has an approved Terms of Reference and annual work plan with deliverables, which were shared with the auditors. However, the report still refers to the absence of an approved ToR and work plan.
- On macro assessments, the draft report is silent on why UN agencies did not integrate the results of the macro assessment within the UNDAF process. One reason may be based on the UN's agencies' mandates and comparative advantages. Matters of public financial management and national audit regimes generally fall within the World Bank's area of expertise, and not of the UN agencies that comprise the UNCT;
- On micro assessments, the draft audit report relies heavily on the statistics derived from the questionnaire mentioned above which may be potentially be misleading. For example, Annex 4 [Annex 5 in the final report] of the draft audit report states that only 13.4% of the IPs are shared, which can stem from various reasons including the degree to which UN agencies in different countries share IP, based on their mandates, priorities, etc. The low number of common IPs should not be an indication of HACT non-compliance or sub-optimal performance. It may be useful if further information and analysis could be provided on whether any differences were found in the way UN agencies deal with "common IPs" in terms of cash transfers, assurance activities, etc.
- The draft audit report also seems to give an impression that for any given common IP, the choice of cash transfer modality should be uniform across all UN agencies. While this may be the ideal scenario, the current framework does allow differences in choice based on the nature of programmatic activities and the corresponding risks associated with each UN agency's work with any given IP.
- In terms of risk management, the HACT framework recognizes macro and micro assessments as methods to support the establishment of the risk level for financial management. If one or both assessments could not be conducted, the framework also has a provision to continue project implementation under the assumption of "high risk". Therefore, absence of one of the assessments as such may not be considered a deficiency. In addition, the guidance note on HACT does provide for other sources of information such as prior audits to be used in lieu of micro assessments.
- UNDP and UNICEF agree that country offices could benefit from clearer guidance on assigning risk levels to projects and implementing partners and correspondingly, in determining the appropriate cash transfer modalities and the required assurance activities. In line with the audit finding, both agencies agree that it is important for such guidance to be jointly developed with other UN agencies to ensure harmonization at the country level. Consequently, UNDP and UNICEF are encouraging country offices to integrate risk ratings from HACT assessments and its corresponding implications into their respective systems.
- With respect to HACT compliance, it may be useful to clarify this issue. The audit report suggests that the assessment of HACT compliance should include the assessment of appropriateness of the level of risks assigned to each IP and of the designed assurance activities. A further discussion on whether the "appropriateness" should be part of the compliance criteria as such (as opposed to "existence"), since it may be quite difficult to

objectively verify "appropriateness". Also, clarity is needed on whether HACT implementation by all agencies determines HACT compliance.

- With respect to the quantitative analysis performed, the coverage of HACT expenditures based on advances were compared to the total biennial expenditures incurred during the period, irrespective of whether some of the funds were to be channeled through HACT or not. In the latter case, the determination of the best cash transfer modality is not even relevant. The results of this analysis yield an extremely low percentage of funds channeled through HACT. This is potentially misleading since the total biennial expenditures contain costs that were not originally designed to be channeled through external IPs (i.e., those projects/programmes that are implemented directly by UN agencies and as such, did not require cash transfers to the external IPs. For UNDP, this amount is fairly significant.).
- In terms of the feasibility of the recommendations, work is on-going to commission the revision of the HACT framework and address key issues identified by the HACT Global Assessment conducted in response to the recommendation from the UNDG-HLCM High Level Mission report. The recommendations made by the HACT Global Assessment mirrors most of the recommendations from the earlier draft audit report which was shared with the HACT AC. It is therefore expected that once launched, the revision to the HACT Framework will address all of the key audit issues."

The Internal Audit Services of UNDP and UNFPA welcome management indications of the revision of the HACT framework, and look forward to its implementation to address the points raised and the recommendation made in this report.

In answer to some other points above, it is recalled that the audit objective was to assess whether the governance arrangements in place were adequate to support an effective implementation of HACT objectives, assisted by a harmonized and well-defined accountability and monitoring structure; and further that multiple sources of information and data, tools and audit procedures were used, as described in section A.

Further, it was noted that the Framework relied on the assumption of a large number of common IPs to harmonize practices and reduce costs; the analysis of UNDG's own data revealed that assumption not to hold true. In addition, while giving flexibility to each agency to choose the most appropriate modality for specific programmes and IPs, the Framework indicates that "it is desirable that agencies agree on a preferred common modality for each IP". If indeed an occasional lack of completion of micro-assessments for certain IPs could be compensated by assessing them as high risk (thereby reducing the level of cash transfers and/or subjecting them to more extensive and frequent assurance activities), the audit disclosed a high risk due to the pervasive lack of completion or consideration of the results of micro-assessments, combined with a low level of execution of assurance activities.

The Framework also promotes that audit activities (which serve a different purpose than micro-assessments) be performed in line with the risk levels assessed. However, the lack of specific guidance on the level of assurance activities required by risk level prevents from providing a basis for assessing the appropriateness of assurance activities.

Annex 2: Definition of Standard Audit Ratings

The following standard audit ratings have been defined so that management can place in context the opinions given in internal audit reports:

- **Satisfactory** - Internal controls, governance and risk management practices were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.
- **Partially Satisfactory** - Internal controls, governance and risk management practices were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of objectives of the audited entity.
- **Unsatisfactory -** Internal controls, governance and risk management practices were either not established or not functioning well. The issues were such that the achievement of the overall objectives of the audited entity could be seriously compromised.

Annex 3: Definition of Priorities of Audit Recommendations

The following five point scales have been used to measure the impact of issues and the likelihood of their occurrence:

- **High (Critical):** Prompt action is required to ensure that the Organizations are not exposed to high risks.
- **Medium (Important):** Action is required to ensure that the Organization is not exposed to significant risks. Failure to take action could result in negative consequences for the Organizations.
- **Low**: Action is desirable and should result in enhanced control or better value for money. Low priority recommendations, if any, are not included in a report, as they are dealt with by the audit team directly with the relevant management, either during the exit meeting or through a separate memo subsequent to the field work.

Annex 4 – UNDG - List of Self-Reported HACT-Compliant Countries

	Self-Reported HACT Compliant Countries – 2011	Self-Reported HACT Compliant Countries – 2010	Self-Reported HACT Compliant Countries – 2009	Self-Reported HACT Compliant Countries – 2008
1	Botswana	Eritrea	Eritrea	Kenya
2	Kenya	Kenya	Kenya	Tanzania
3	Malawi	Malawi	Malawi	Gambia
4	Mozambique	Mozambique	Mozambique	Guinea Bissau
5	Tanzania	Tanzania	Tanzania	Bhutan
6	Congo (DRC)	Gambia	Gambia	Indonesia
7	Gambia	Guinea Bissau	Guinea Bissau	Lao PDR
8	Guinea Bissau	Morocco	Morocco	Philippines
9	Nigeria	Bhutan	Bhutan	Vietnam
10	Jordan	Indonesia	Indonesia	Belize
11	Bhutan	Lao PDR	Maldives	Dominican Republic
12	Indonesia	Maldives	Philippines	Honduras
13	Lao PDR	Nepal	Vietnam	Uruguay
14	Malaysia	Philippines	Belize	
15	Maldives	Vietnam	Dominican Republic	
16	Nepal	Belize	Honduras	
17	Philippines	Colombia	Uruguay	
18	Samoa	Honduras		
19	Cook Islands	Uruguay		
20	Kiribati			
21	Solomon Islands			
22	Vanuatu			
23	Thailand			
24	Vietnam			
25	Azerbaijan			
26	Kosovo			
27	Guatemala			
28	Suriname			
29	Uruguay			

Annex 5 – List of IPs and Shared IPs by two or more Organizations by Country - UNDG

Country		Number of IPs					Shared IPs	
Region	Name	UNDP	UNFPA	UNICEF	WFP	Total	N[b]	%
East and Southern Africa	Angola	49	12	48		109	15	13.7
	Botswana	15	6	18		39	9	23.1
	Comoros Islands	18	1	26		45	7	15.6
	Lesotho	17	4	29	4	54	25	46.3
	Malawi	21	4	53	1	79	8	10.1
	Mozambique	24	35	154	36	249	12	5.0
	Namibia	2	3	7		12	3	25.0
	Rwanda	29	53	87		169	29	17.1
	Tanzania	31	2	34		67	17	25.4
	Uganda	39	29	93	3	164	38	23.2
	Zambia	11	10	152		173	8	4.6
West and Central Africa	Burkina Faso	39	10	260	5	314	25	11.7
	Cameroon	20	5	7	6	38	7	18.4
	Central African Republic	10	10	22	3	45	20	44.4
	Senegal	10	6	12		28	28	100.0
	Sierra Leone	45	16	67	19	147	8	5.4
	Togo	21	4	14		39	13	33.3
Arab States	Djibouti	1	2	4		7	2	28.6
	Lebanon	3	9	18		30	2	6.7
Asia and the Pacific	Afghanistan	19	13	12		44		
	Bangladesh	19	26	87	44	176	22	12.5
	China	7	11	40		58	3	5.2
	Maldives	15	2	2		19	8	42.1
	Pakistan	27	12	82		121	4	3.3
	Sri Lanka	9	2	36		47	6	12.8
Europe and CIS	Armenia	4	2	25		31		
	Kazakhstan	13		18		31	1	3.2
	Moldova	10		3		13	1	7.8
	Tajikistan	11	4	40		55	5	9.1
Latin America and the Caribbean	Chile	18	4	6		28	5	17.9
	Colombia	21	10	43		74	3	4.1
	Dominican Republic	10	2	2		14	1	7.1
	Guyana	8		45		53	4	7.5
	Mexico	16	2	7		25	1	4.3
	Peru	32	6	2		40	5	12.5
	Uruguay	9	2			11	10	90.9
Total		**653**	**319**	**1555**	**121**	**2,648**	**355**	**13.4%**

Source: UNDG data (non audited)

Annex 6 – List of Countries without Government Agreement on HACT

Asia and the Pacific	**Latin America and the Caribbean**
DPR Korea	Argentina
Iran	Barbados & OECS
Myanmar	Cuba
Pakistan	Haiti
Nauru	Mexico
Palau	Paraguay
Tuvalu	Trinidad & Tobago
Timor Leste	Venezuela
Europe and Commonwealth of Independent States	**East and Southern Africa**
Azerbaijan	Mauritius
Belarus	Seychelles
Bulgaria	South Sudan
Kyrgyzstan	
Latvia	**West and Central Africa**
Lithuania	Chad
Poland	Cote D'Ivoire
Romania	Congo (DRC)
Russian Federation	Gabon
Tajikistan	Guinea
Turkey	
Turkmenistan	**Arab States**
Ukraine	Algeria
Uzbekistan	Bahrain
	Libya
	Occupied Palestinian territory
	Saudi Arabia
	Somalia
	Tunisia
	UAE & Qatar

Annex 7 – List of the Top 30 Countries by Expenditures UNDP, UNFPA and UNICEF – Amounts in Thousands of US Dollars

Country Office	UNDP	UNFPA	UNICEF	Total	HACT Compliant according to UNDG
Afghanistan	984,588	9,209	75,234	1,069,031	No
Democratic Republic of the Congo	403,784	16,267	113,245	533,296	**Yes**
Sudan-North	466,905	15,790	27,664	510,359	No
Panama	331,267	1,391	1,165	332,432	No
Argentina	304,259	1,301	1,417	306,977	No
Brazil	266,007	2,988	2,848	271,843	No
Bangladesh	179,586	12,867	42,943	235,396	No
Colombia	179,574	8,304	13,613	201,491	No
Peru	193,243	4,031	1,798	199,072	No
Ethiopia	94,384	11,384	81,774	187,542	No
Nigeria	76,210	14,625	92,130	182,965	**Yes**
India	82,636	21,064	78,624	182,324	No
Iraq	167,066	3,381	4,050	174,497	No
China	141,868	10,069	22,492	174,429	No
Indonesia	146,267	11,057	11,519	168,843	**Yes**
Somalia	143,625	4,149	18,662	166,436	No
Programme for Palestinian People	151,670	3,856	8,610	164,136	No
Egypt	148,356	5,177	6,412	159,945	No
Guatemala	145,831	2,509	2,429	150,769	**Yes**
Liberia	127,038	6,218	11,300	144,556	No
Pakistan	84,137	14,625	36,863	135,625	No
Honduras	107,263	4,043	1,534	112,840	No
Myanmar	66,812	11,753	30,877	109,442	No
Côte d'Ivoire	79,922	10,421	16,114	106,457	No
Cambodia	82,497	8,304	13,613	104,414	No
Lebanon	96,086	1,173	1,360	98,619	**Yes**
Nepal	74,408	9,947	13,401	97,756	No
Angola	67,747	4,702	24,749	97,198	No
Burundi	72,670	4,658	19,053	96,381	No
Sierra Leone	68,286	5,988	16,699	90,973	No
Expenditures - Top 30	**5,533,992**	**239,860**	**792,192**	**6,566,044**	
Total Expenditures	**8,696,538**	**541,848**	**1,433,909**	**10,672,295**	
Top 30 as a % of Total	**64%**	**44%**	**55%**	**62%**	

Source: For UNFPA and UNICEF – Expenditures obtained from the Financial Statements for the biennium ended 31 December 2009. For UNDP – Expenditures obtained from Atlas