



## INTERNAL AUDIT DIVISION

### REPORT 2014/050

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Audit of United Nations Human Settlements Programme operations in Sri Lanka

Overall results relating to the effective and efficient implementation of the UN-Habitat programme in Sri Lanka were initially assessed as partially satisfactory. Implementation of three important recommendations remains in progress.

FINAL OVERALL RATING: PARTIALLY SATISFACTORY

12 June 2014  
Assignment No. AA2013/250/03

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# AUDIT REPORT

## Audit of United Nations Human Settlements Programme operations in Sri Lanka

### I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of United Nations Human Settlements Programme (UN-Habitat) operations in Sri Lanka.
2. In accordance with its mandate, OIOS provides assurance and advice on the adequacy and effectiveness of the United Nations internal control system, the primary objectives of which are to ensure (a) efficient and effective operations; (b) accurate financial and operational reporting; (c) safeguarding of assets; and (d) compliance with mandates, regulations and rules.
3. UN-Habitat is mandated by the United Nations General Assembly to promote socially and environmentally sustainable towns and cities with the goal of providing adequate shelter for all. The UN-Habitat programme in Sri Lanka (or the Sri Lanka Project Office) was focused, from 2011 to 2013, primarily on the provision of permanent housing and community infrastructure, through community mobilization processes, to communities affected by a thirty-year civil war that ended in January 2009 after having disrupted civilian life, displaced 330,000 people during the final stage of the conflict, and damaged 150,000 houses in the northern districts of Sri Lanka. The programme also contributed to the development of policies and tools in urban planning, climate change and disaster risk reduction, credit enhancement, livelihood assessment and settlement upgrades.
4. The programme portfolio, during the period January 2011 to October 2013, consisted of 15 projects valued in excess of \$66 million funded by a core group of donors. As at October 2013, the programme was located across nine areas of intervention and six project offices and was being executed by a workforce of 220 national project staff, two international consultants and one international staff. Most of the project staff were contracted through the United Nations Office for Project Services and had prior experience with UN-Habitat and other specialized agencies, funds and programmes of the United Nations, as well as Non-Governmental Organizations and the Sri Lanka Government during the post-tsunami and conflict stage during the period from 2005 to 2010.
5. During the period under review (January 2011 to October 2013), overall project expenditures amounted to \$28.4 million and contributed to UN-Habitat \$2.1 million of income as programme support cost. The audit focused on 10 projects whose expenditures amounted to \$28.1 million and represented 99 per cent of the total project portfolio expenditures during the period January 2011 to October 2013.
6. Comments provided by UN-Habitat are incorporated in *italics*.

### II. OBJECTIVE AND SCOPE

7. The audit was conducted to assess the adequacy and effectiveness of UN-Habitat governance, risk management and control processes in providing reasonable assurance regarding **the effective and efficient implementation of the UN-Habitat programme in Sri Lanka.**

8. The audit was included in the 2013 internal audit work plan due to high operational and compliance risks in the implementation of UN-Habitat operations in Sri Lanka.

9. The key controls tested for the audit were: (a) performance monitoring indicators and mechanisms; (b) regulatory framework; and (c) security management systems. For the purpose of this audit, OIOS defined these key controls as follows:

(a) **Performance monitoring indicators and mechanisms** - controls that provide reasonable assurance that metrics are established to monitor performance, and are used to manage operations effectively.

(b) **Regulatory framework** - controls that provide reasonable assurance that policies and procedures: (i) exist to guide the efficient and effective implementation of the UN-Habitat programme in Sri Lanka; (ii) are implemented consistently; and (iii) ensure the reliability and integrity of financial and operational information.

(c) **Security management systems** - controls that provide reasonable assurance that security management systems are in place, commensurate with the safety and security risks. This includes compliance with the Minimum Operating Security Standards (MOSS).

10. The key controls were assessed for the control objectives shown in Table 1. Certain control objectives (shown in Table 1 as “Not assessed”) were not relevant to the scope defined for this audit.

11. OIOS conducted this audit from 15 November 2013 to 13 January 2014. The audit covered the period from January 2011 to October 2013. The audit team conducted field visits, interviewed beneficiaries, donors and project staff, and reviewed mechanisms for monitoring and reporting performance internally and to donors. OIOS reviewed the controls and documentation related to disbursements to beneficiaries and implementing partners, procurement of goods and services, and cash management. The audit team also verified the existence of tangible assets reportable under the International Public Sector Accounting Standards (IPSAS) against records kept at UN-Habitat Headquarters in Nairobi. OIOS also reviewed status of implementation of recommendations made by the United Nations Department for Safety and Security (DSS) in order to ensure compliance with country-specific MOSS.

12. OIOS conducted an activity-level risk assessment to identify and assess specific risk exposures, and to confirm the relevance of the selected key controls in mitigating associated risks. Through interviews, analytical reviews and tests of controls, OIOS assessed the existence and adequacy of internal controls and conducted necessary tests to determine their effectiveness.

### III. AUDIT RESULTS

13. UN-Habitat governance, risk management and control processes examined were initially assessed as **partially satisfactory** in providing reasonable assurance regarding **the effective and efficient implementation of the UN-Habitat programme in Sri Lanka**. OIOS made three recommendations to address issues identified in the audit. UN-Habitat Sri Lanka had put in place adequate monitoring and reporting mechanisms to deliver its programme of work. Controls over budgeting, disbursements and bank reconciliations were generally satisfactory or had been strengthened. However, there was need to dispose of the unspent balances relating to closed projects by either returning the funds to donors or securing their agreement for alternative use. More effective control was needed from UN-Habitat Headquarters on the procurement of goods and services to ensure compliance with the provisions of the

Procurement Manual. There was also a need to provide adequate resources to implement the recommendations made by the United Nations Department of Safety and Security (DSS) to achieve compliance with MOSS.

14. The initial overall rating was based on the assessment of key controls presented in Table 1 below. The final overall rating is **partially satisfactory** as implementation of three important recommendations remains in progress.

**Table 1: Assessment of key controls**

Business objective	Key controls	Control objectives			
		Efficient and effective operations	Accurate financial and operational reporting	Safeguarding of assets	Compliance with mandates, regulations and rules
<b>Effective and efficient implementation of the UN-Habitat operations in Sri Lanka</b>	(a) Performance monitoring indicators and mechanisms	Satisfactory	Satisfactory	Satisfactory	Satisfactory
	(b) Regulatory framework	Partially satisfactory	Satisfactory	Satisfactory	Partially satisfactory
	(c) Security management systems	Partially satisfactory	Not assessed	Partially Satisfactory	Partially satisfactory

### **A. Performance monitoring indicators and mechanisms**

Performance indicators had been defined at the project output level

15. Performance indicators which are specific, measurable and relevant to the project activities being carried out enable the monitoring of progress and the assessment of the immediate output generated by these activities.

16. Intended outputs were stated in the respective project documents and subsequent amendments which were approved by the Regional Office for Asia and the Pacific (ROAP) and aimed at a target population often affected by multiple displacements as a consequence of conflict and natural disasters. The modality for implementation was either direct implementation by UN-Habitat, or through partnerships with the Sri Lankan central and local Government, women and community based organizations, among others. Projects were also aimed at contributing to the achievement of gender and environment related goals through the integration of these two cross-cutting issues in the design and delivery of the resettlement projects. OIOS reviewed project documentation related to 10 key projects which represented 99 per cent of the project portfolio and concluded that the performance indicators and project outputs were adequately defined.

Sri Lanka Project Office had established an appropriate internal performance monitoring and reporting system

17. An appropriate performance monitoring system is necessary to enable the monitoring and reporting of progress to internal and external stake-holders and assess the immediate output generated by project activities. The UN-Habitat Project Office in Sri Lanka had developed an adequate system for

monitoring and reviewing performance to ensure effective project delivery. Progress reports, both financial and substantive, were prepared for internal and external stakeholders. Internal reports on procurement, and listings of agreements entered into with implementing partners, were submitted to UN-Habitat Headquarters in Nairobi on a monthly basis, while inventory reports were prepared and submitted twice every year. External reports to donors were prepared in accordance with the timelines specified in the respective donor agreements.

18. OIOS tested the controls by interviewing the actors involved, observing activities during field visits, and reconciling data in the database with data held by beneficiaries and concluded that these were adequate and functioning as intended.

#### Deliverables of the project portfolio were consistent with project documentation

19. Deliverables need to be defined in sufficient detail and documented to ensure that the intended outputs/results of the project are delivered. The Project Office's substantive performance was supported by project documentation. As part of field visits, OIOS reviewed project documentation and deliverables, inspected records kept by beneficiaries, and interviewed beneficiaries, project staff, as well as representatives from local government and donors. OIOS inspection of project sites related to the construction of 36 houses, four community infrastructures and one road segment located across 13 different locations within four districts in the northern and eastern parts of the country indicated that the reported performance was accurate.

20. OIOS concluded that the inspected deliverables were consistent with project documentation.

## **B. Regulatory framework**

#### Sri Lanka Project Office had established an adequate budgeting process

21. The UN-Habitat project manual for field operations (2010) provides the framework for planning and budgeting for UN-Habitat programmers. It highlights the key considerations to be incorporated in project budgets and outlines the procedures and guidelines pertaining to the preparation, approval and revision of budgets.

22. UN-Habitat's financial and operational budgets were project and donor specific and were prepared during the project design phase, usually at the proposal preparation stage. The budgets were prepared by the Project Management Unit, reviewed and authorized by the Chief Technical Advisor, and eventually approved by ROAP in Fukuoka, Japan. Budget amendments and revisions thereto were discussed with donors and approved by the Regional Office or UN-Habitat Headquarters in Nairobi, Kenya. OIOS therefore concluded that the budgeting process was operating satisfactorily.

#### Controls over disbursement to implementing partners were strengthened

23. UN-Habitat policy and procedures for clearing agreements and legal instruments and the standard operating procedures for Agreements of Cooperation (2012) define the requirements for approval and extension of agreements, and for oversight, monitoring of activities and use of funds by implementing entities (partners), respectively. OIOS reviewed 14 "Agreements of Cooperation" with institutional partners and Non-Governmental Organizations and concluded that they were approved and extended by ROAP in line with applicable UN-Habitat policies. OIOS also reviewed 21 related disbursements and documentation of expenditures where relevant, and concluded that these were generally performed in line with requirements and modalities stated in the respective agreement. In five cases, however, the

performance evaluation, which was required as justification for subsequent disbursement of funds, was not attached to ensure that work had been delivered in line with contractual requirements. As at January 2014, the Project Office confirmed that it had started to review all requests for payment to ensure that a satisfactory performance evaluation report was completed before funds were disbursed. In view of the actions already taken, no recommendation was made.

#### Controls over vetting and selection of beneficiaries were adequate

24. Adequate controls and procedures were needed for vetting and selecting beneficiaries, and ensuring that project funds were only disbursed to eligible and bona fide beneficiaries.

25. Seven out of the ten housing projects reviewed by OIOS had a component for direct implementation through grants to beneficiaries (displaced communities/returnees) for housing and community infrastructure reconstruction and repairs in the northern and eastern parts of the country. Within this component, OIOS inspected the construction of 36 houses.

26. One of the main challenges to implementing the housing project was the vetting of beneficiaries. UN-Habitat had established controls and procedures for vetting and selecting beneficiaries, and ensuring that project funds were only disbursed to eligible and bona fide beneficiaries. Key features of these controls and procedures included the following:

- Rigorous eligibility criteria and elaborate beneficiary scoring system to ensure that assistance was provided only to the most vulnerable families;
- The involvement of government officials, community leaders and members in validating the eligibility of beneficiaries;
- The wide publishing of beneficiary names to enhance openness and transparency of the beneficiary selection process;
- An open grievance resolution process that provided redress to those beneficiaries that may have been unfairly left out; and
- Appropriate controls over the processing of beneficiary payments to ensure that funds are released to bona fide beneficiaries and only upon achievement of agreed milestones.

27. OIOS reviewed the application of these criteria on a sample of 36 project beneficiaries by documenting the process for the selection of beneficiaries and validating this documentation during field inspections and noted that the criteria were consistently applied, and the controls were operating satisfactorily.

#### Unspent balances relating to closed projects needed to be cleared

28. As at October 2013, two projects reported as operationally closed in 2011 and 2012, respectively, still had unspent balances for \$12,421 and \$5,344 respectively, which needed to be returned to the donors. Financial closure of projects, according to the UN-Habitat project manual, requires that all pending liabilities are settled and unspent funds returned, or clearance is obtained from donors on the alternative treatment of unutilized balances. Failure to comply with requirements for financial closure of projects may result in financial and reputational risks for UN-Habitat.

<p><b>(1) The UN-Habitat Executive Director should ensure that projects are financially closed in accordance with the UN-Habitat project manual, and that unspent funds are either returned to donors or utilized for alternative purposes with donor prior approval.</b></p>
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*UN-Habitat accepted recommendation 1 and stated that it has now completed financial closures of the two projects referred to above. Final financial reports to donors are being finalized and the future use of unspent balances will be discussed and agreed with donors. Recommendation 1 remains open pending receipt of evidence of return of funds to donors or clearance for alternative use in compliance with the UN-Habitat project manual.*

There were weaknesses in compliance with procurement procedures

29. There were weaknesses in the manner in which procurement actions were performed and documented. Out of 162 procurement transactions (with a value of \$1.08 million) processed by the Project Office during the period under review, OIOS selected and tested a sample of 25, worth \$561,446. Results of these tests are noted in the following paragraphs.

30. The Procurement Manual requires formal competitive bidding for the procurement of goods with an estimated value in excess of \$40,000. OIOS noted one instance where the original requirement for 178 Microsoft Office software licenses with an estimated value of LKR7.6 million (approximately \$58,000) was reduced to make a part purchase of 130 software licenses valued at \$39,700, evidently to keep the purchase within the threshold of \$40,000 for competitive bidding. Management reported that this was done to ensure the acquisition of software licenses that were urgently and immediately required. However, the justification for the urgent requirement was not documented, and no attempt was made to obtain exemption from using formal methods of solicitation, as required by the Procurement Manual. The remaining 48 software licenses were not purchased subsequently; instead, 15 computers with preloaded (bundled) software were purchased. The splitting of purchases constituted circumvention of applicable procurement procedures, which undermined the principle of fair, open and transparent procurement.

31. In another instance, UN-Habitat acquired geographical information services at a cost of \$39,000 on a single-source basis. However there was no justification on record, as required by the Procurement Manual, for procuring these services on a sole-source basis.

32. The Project Office did not always file supporting documents. In one instance, copies of quotations obtained during the procurement of office accommodation were not attached to the payment vouchers. Similarly, in three other instances, payment advice in support of LKR6.7 million (approximately \$56,000) paid as rent for three project offices were not attached to the payment vouchers. Proper record keeping is important to demonstrate that procurement actions were valid and were made in a fair and transparent manner.

**(2) The UN-Habitat Executive Director should establish a mechanism to ensure that the Sri Lanka Project Office: (a) complies with the provisions of the Procurement Manual on competitive bidding; and (b) keeps proper records to support the payments made to vendors.**

*UN-Habitat accepted recommendation 2 and stated that while there was no breach of procurement rules, it will strengthen its oversight of procurement actions and design a process for monitoring any possible exception to rules. UN-Habitat will devise a control mechanism which will ensure that all necessary supporting documentation is attached to each payment processing and properly filed for easy retrieval. Recommendation 2 remains open pending receipt of documentation showing the actions taken by UN-Habitat to ensure that the Project Office in Sri Lanka complies with the provisions of the Procurement Manual.*



Assets reportable under the International Public Sector Accounting Standards had been identified and valued to determine the opening balance

33. The United Nations IPSAS framework policy for UN-Habitat requires property and equipment with a value above \$5,000 to be identified and reported in the financial statements. To this end, UN-Habitat was required to maintain adequate documentation to support the values, and confirm ownership and/or control of the assets to be reported in the financial statements. UN-Habitat completed a review of assets held in Sri Lanka as at 31 December 2013 and identified 18 items valued at \$410,711 to be reported in the financial statements under IPSAS that met the threshold, ownership and control requirements. OIOS reviewed the existence and related documentation pertaining to these assets and concluded that UN-Habitat had complied with IPSAS requirements.

### **C. Security management systems**

Minimum Operating Security Standards were partially complied with

34. DSS policies require security team meetings to be held regularly and UN agencies, funds and programmes to comply with country specific MOSS established at each location. Country and Area level security management team meetings were regularly held and attended by designated UN-Habitat project staff. DSS had surveyed all office locations in Sri Lanka and as at 12 November 2013, issued 44 recommendations to ensure full MOSS compliance. The Sri Lanka Project Office reported that it was currently working on addressing the recommendations and that additional funding was required to ensure full compliance.

**(3) The UN-Habitat Executive Director should develop an action plan for implementing the Department of Safety and Security recommendations on a timely basis to ensure compliance with the Minimum Operating Security Standards.**

*UN-Habitat accepted recommendation 3 and stated that since the audit was undertaken, a number of DSS recommendations have been completed on all six offices, others are underway. UN-Habitat will budget and work for full compliance. Recommendation 3 remains open pending receipt of evidence of compliance with MOSS.*

## **IV. ACKNOWLEDGEMENT**

35. OIOS wishes to express its appreciation to the Management and staff of UN-Habitat for the assistance and cooperation extended to the auditors during this assignment.

(Signed) David Kanja  
Assistant Secretary-General for Internal Oversight Services

## STATUS OF AUDIT RECOMMENDATIONS

## Audit of United Nations Human Settlements Programme operations in Sri Lanka

Recom. no.	Recommendation	Critical <sup>1</sup> / Important <sup>2</sup>	C/ O <sup>3</sup>	Actions needed to close recommendation	Implementation date <sup>4</sup>
1	The UN-Habitat Executive Director should ensure that projects are financially closed in accordance with the UN-Habitat project manual, and that unspent funds are either returned to donors or utilized for alternative purposes with donor prior approval.	Important	O	Receipt of evidence of return of funds to donors or clearance for alternative use in compliance with the UN-Habitat project manual.	31 July 2014
2	The UN-Habitat Executive Director should establish a mechanism to ensure that the Sri Lanka Project Office: (a) complies with the provisions of the Procurement Manual on competitive bidding; and (b) keeps proper records to support the payments made to vendors.	Important	O	Receipt of documentation showing the actions taken by UN-Habitat to ensure that the Project Office in Sri Lanka complies with the provisions of the Procurement Manual.	31 July 2014
3	The UN-Habitat Executive Director should review develop an action plan for implementing the Department of Safety and Security recommendations on a timely basis to ensure compliance with the Minimum Operating Security Standards.	Important	O	Receipt of evidence of compliance with MOSS.	31 January 2015

<sup>1</sup> Critical recommendations address significant and/or pervasive deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance cannot be provided regarding the achievement of control and/or business objectives under review.

<sup>2</sup> Important recommendations address important deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance may be at risk regarding the achievement of control and/or business objectives under review.

<sup>3</sup> C = closed, O = open

<sup>4</sup> Date provided by UN-Habitat in response to recommendations.

# **APPENDIX I**

## **Management Response**

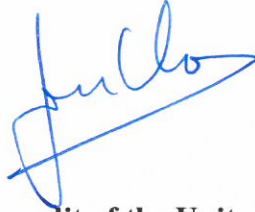
**MEMORANDUM**

To: Gurpur N. Kumar, Deputy Director  
Internal Audit Division, OIOS

Reference:

Through:

From: Dr. Joan Clos  
Executive Director  
UN-Habitat



Date: 04 June 2014

Subject: **Draft report on an audit of the United Nations Human Settlements Programme operations in Sri Lanka (Assignment No. AA2013/250/03)**

I refer to your Draft Report on the above mentioned audit dated 12 May 2014 addressed to me and requesting comments.

I am pleased to present in attached Appendix I, an action plan with target dates and the title of the individual responsible for implementation of each recommendation. We take this opportunity to thank the Office of Internal Oversight Services (OIOS) for the services it provided to UN-Habitat on the above-mentioned audit.

## AUDIT RECOMMENDATIONS

## Audit of United Nations Human Settlements Programme operations in Sri Lanka

Rec. no.	Recommendation	Critical <sup>1</sup> / Important <sup>2</sup>	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
1	The UN-Habitat Executive Director should ensure that projects are financially closed in accordance with the UN-Habitat project manual, and that unspent funds are either returned to donors or utilized for alternative purposes with donor prior approval.	Important	Accepted	Chief Technical Advisor, UN-Habitat Sri Lanka Office	31 July 2014	UN-Habitat has now completed financial closures of the two projects referred to in para. 30, final financial reports to Donors are being finalized and the future use of unspent balances will be discussed and agreed with Donors
2	The UN-Habitat Executive Director should establish a mechanism to ensure that the Sri Lanka Project Office: (a) complies with the provisions of the Procurement Manual on competitive bidding; and (b) keeps proper records to support the payments made to vendors.	Important	Accepted	Methods & Oversight Officer Office of Management UN-Habitat	31 July 2014	Please replace the current UN-Habitat comments in para 36 as follows "UN-Habitat accepts the recommendation and wishes to clarify <ul style="list-style-type: none"> <li>• (para.33); There was no breach of the UN bidding procurement rule as this single procurement action was below the bidding requirement threshold of USD 40,000 and no splitting did in fact took place.</li> <li>• (para.34); This is not a sole-sourced purchase, UN-Habitat has a global agreement with the GIS software company. This company has a sole agent in Sri Lanka and UN-Habitat had to procure from them, irrespective of total value.</li> <li>• While there was no breach of procurement rules on each above case, UN-Habitat accepts the recommendation 2 (a) in order to strengthen its oversight of procurement actions and will design a HQ process monitoring any possible exception to</li> </ul>

<sup>1</sup> Critical recommendations address significant and/or pervasive deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance cannot be provided regarding the achievement of control and/or business objectives under review.

<sup>2</sup> Important recommendations address important deficiencies or weaknesses in governance, risk management or internal control processes, such that reasonable assurance may be at risk regarding the achievement of control and/or business objectives under review.

Rec. no.	Recommendation	Critical <sup>1</sup> / Important <sup>2</sup>	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
						<p>rules.</p> <ul style="list-style-type: none"> <li>(para.35); While the documentation was not attached to payment vouchers, UN-Habitat Sri Lanka has all necessary documentation supporting each payment referred to in the para.35. However UN-Habitat accepts recommendation 2 (b) and will devise a control mechanism which will ensure all necessary supporting documentation is attached to each payment processing and properly filed for easy retrieval and records keeping purposes.</li> </ul>
3	The UN-Habitat Executive Director should review develop an action plan for implementing the Department of Safety and Security recommendations on a timely basis to ensure compliance with the Minimum Operating Security Standards.	Important	Accepted	Chief Technical Advisor, UN-Habitat Sri Lanka Office	31 January 2015	Since the audit was undertaken, a number of DSS recommendations have been completed on all six offices, others are underway. UN-Habitat will budget and work for full compliance.