



INTERNAL AUDIT DIVISION

REPORT 2016/119

Audit of the management of the United Nations Democracy Fund

While the activities relating to the Fund were generally performed in accordance with applicable guidelines, there was need to strengthen due diligence checks and implement a plan to reduce evaluation costs

17 October 2016
Assignment No. AG2016/524/01

Audit of the management of the United Nations Democracy Fund

EXECUTIVE SUMMARY

The objective of the audit was to assess the adequacy and effectiveness of governance, risk management and control processes over the effective management of the United Nations Democracy Fund (UNDEF). The audit covered the period from 1 January 2014 to 31 December 2015 and included a review of resource mobilization, selection of grantees, donor reporting, and monitoring and evaluation of projects.

The audit showed that UNDEF activities were generally performed in accordance with applicable guidelines to meet the primary purpose of the Fund. UNDEF had adequate controls over the selection of independent assessors and monitoring of projects. Donor reporting requirements were complied with. Although UNDEF conducted capacity assessments for determining the capacity of grantees to implement projects, it was yet to adequately conduct and document due diligence checks to ensure that the risk to the reputation of the Organization is adequately mitigated. While UNDEF had developed a plan to reduce the cost of external evaluation of projects, the plan was yet to be submitted to the UNDEF Advisory Board for approval.

OIOS made two recommendations to address these issues, as follows:

- UNDEF should establish a mechanism to strengthen capacity assessments, as well as adequately conduct and document due diligence checks on each grantee before the approval of projects to mitigate the risk to the Organization's reputation; and
- UNDEF should formalize the plan for future post-project evaluations with the approval of the Advisory Board and institute a mechanism to monitor the costs of project evaluation in future.

UNDEF accepted both these recommendations.

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Audit of the management of the United Nations Democracy Fund

I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of the management of the United Nations Democracy Fund.
2. UNDEF was established in 2005 to promote democracy throughout the world by providing assistance for projects that build and strengthen democratic institutions and facilitate democratic governance in new, emerging and consolidated democracies. The seven thematic areas for UNDEF projects included rule of law and human rights, women's empowerment, youth engagement, media and freedom of information, tools for knowledge, community activism and strengthening interaction with government. UNDEF, which received approximately 2,000 proposals annually, used independent assessors to vet the proposals against 10 criteria before reducing the list to about 300 (long list). After obtaining feedback from stakeholders, UNDEF submitted a short list of 50 proposals for approval by the Secretary-General.
3. UNDEF provided grants ranging from \$90,000 to \$325,000 per project, and a typical project lasted about 24 months. Grantees included non-government organizations, government bodies, civil society organizations, regional entities and departments of the United Nations Secretariat. UNDEF supported 52 projects in 2014 and 53 in 2015.
4. UNDEF relied entirely on voluntary contributions from Member States, which were pooled in a trust fund. Table 1 shows the total income and expenditure of the trust fund for the biennium 2014-2015.

Table 1: Summary of total income and expenditure and balance sheet for UNDEF

Particulars	2015 (000's of USD)	2014 (000's of USD)
Revenue	11,205	6,196
Expenditure	12,346	8,308
Excess (Surplus)	(1,139)	(2,112)
Total assets	40,285	41,376
Total liabilities	6,461	6,413
Total net assets	33,824	34,963

Source: Interim statement of financial position as at 31 December 2015

5. UNDEF was managed by an Executive Head who was supported by three Professional and three General Service staff. The Executive Head reported to the Executive Director of the United Nations Office for Partnerships (UNOP) on administrative matters and the Advisory Board on substantive matters. The Advisory Board comprised of 13 Member States, three individual members, two civil society organizations and the Executive Director of UNOP, who served in an ex officio capacity.
6. The Secretary-General established a Programme Consultative Group (PCG) to support the Advisory Board on programme funding criteria and project proposals. PCG comprised of senior representatives from the Department of Political Affairs, the Department of Peacekeeping Operations, the United Nations Development Programme, the Office of the High Commissioner for Human Rights, United Nations Women, and the United Nations Office on Drugs and Crime.
7. Comments provided by UNDEF are incorporated in italics.

II. AUDIT OBJECTIVE, SCOPE AND METHODOLOGY

8. The objective of the audit was to assess the adequacy and effectiveness of governance, risk management and control processes over the effective management of UNDEF.

9. This audit was included in the 2016 risk-based work plan of OIOS due to the risk that potential weaknesses in management of UNDEF could adversely affect donor confidence as well as its effectiveness in achieving its objectives.

10. OIOS conducted the audit from February 2016 to June 2016. The audit covered the period from 1 January 2014 to 31 December 2015. Based on an activity-level risk assessment, the audit covered higher and medium risk areas in the management of UNDEF, which included resource mobilization, selection of grantees, donor reporting, and monitoring and evaluation of projects.

11. The audit methodology included: (a) interviews of key personnel, (b) review of relevant documentation, (c) analytical reviews of data, and (d) sample testing. Using a stratified sampling method, the audit team selected for detailed review a representative sample of 30 projects amounting to \$6.5 million out of a total 105 projects.

III. OVERALL CONCLUSION

12. UNDEF activities were generally performed in accordance with applicable guidelines to meet the primary purpose of the Fund. UNDEF had adequate controls over the selection of independent assessors and monitoring of projects. Donor reporting requirements were complied with. However, UNDEF needed to: (a) establish a mechanism to strengthen capacity assessments, as well as adequately conduct and document due diligence checks on each grantee before the approval of projects to mitigate the risk to the Organization's reputation; and (b) formalize and implement a plan for future post project evaluations with the approval of the Advisory Board and institute a mechanism to monitor the costs of project evaluation in future.

IV. AUDIT RESULTS

Trust fund activities

Substantive activities and priorities were in accordance with the UNDEF terms of reference

13. According to the terms of reference of UNDEF, the purpose of the trust fund was to promote democracy throughout the world. OIOS review of the planned activities of 30 sample projects with a total grant amount of \$6.5 million showed that project objectives generally matched the primary purpose of the trust fund and fell within the seven thematic areas. OIOS also reviewed the milestone verification reports, narrative reports and evaluation reports developed after implementation of projects to determine whether the outputs and outcomes were in line with the project documents. Based on these reviews, OIOS concluded that the substantive activities relating to the selected projects were aligned to the vision and primary purpose of the trust fund and were in accordance with the trust fund's terms of reference.

UNDEF made attempts to address the issue of reduction in contributions from donors

14. According to the Secretary-General's Bulletin on the Organization of UNOP, the Executive Head of UNDEF was responsible for conducting resource mobilization activities.

15. There had been a reduction in contributions from Member States since the establishment of UNDEF in 2005 and a consequent drop in the number of projects supported. In 2005, UNDEF received contributions amounting to \$27 million from 16 donors and supported 125 projects; however, contributions in 2014 and 2015 amounted to \$6 million and \$11 million respectively and the number of projects supported reduced to around 50 annually during 2014-2015. The number of donors had decreased from 14 in 2014 to 11 in 2015. UNDEF explained that the decline in Member States' contributions was largely attributable to a change in government priorities over the years, particularly from the larger donors, which subsequently had an effect on other donors' contributions. The global economic crisis and reconfiguration of development and related funding also had a negative impact on funding to UNDEF.

16. UNDEF stated that it conducted various outreach activities during the year. A review of semiannual Advisory Board meeting minutes indicated that UNDEF actively reached out to Member States and requested further funding. UNDEF marked the International Day of Democracy where it further publicized its activities. UNDEF stated that major donors represented them to existing or potential donors to obtain more funding. As a result of various resource mobilization activities, UNDEF secured a multi-year agreement with one donor to receive \$5 million for a period of three years, and another donor increased its contribution from \$1 million to \$1.7 million. An additional donor renewed its funding after a six-year absence. UNDEF stated that these efforts would continue to ensure that adequate resources were available for future operations. In view of the actions taken by UNDEF, OIOS did not make a recommendation on this matter.

Need to strengthen capacity assessment and due diligence checks relating to grantees

17. UNDEF project document guidelines requires that grantees should submit an audit comfort letter confirming they had the controls to satisfactorily implement the activities as well as audited financial statements and operating budgets and annual reports for the previous two years. In addition, UNDEF was required to obtain feedback from the United Nations Resident Coordinators, PCG and other United Nations agencies regarding their knowledge and working experience of the civil society organizations and non-governmental organizations as part of the due diligence process.

18. OIOS review of 30 sample projects indicated that there was no evidence that UNDEF received feedback from Resident Coordinators/PCG in eight cases, and financial statements from grantees in six cases. UNDEF explained that feedback was not received in some cases despite reminders. With regard to financial statements received from grantees: in four cases it was unclear whether they had been audited; in one case the auditor gave a qualified opinion; and in another, the auditor gave a disclaimer. For these grantees, UNDEF stated that it considered additional information obtained from other United Nations entities before approving the projects. One grantee with an annual income of \$6,277 in 2013 was approved to receive a grant of \$225,000 over 24 months. This grantee had received an initial disbursement of \$77,000 in January 2015 but there were delays in starting the project. UNDEF stated that the project started in April 2016 and no additional disbursements would be made to the grantee.

19. UNDEF explained that it had considered all available information regarding the capacity of the grantees and had performed due diligence before approving the projects, but that these assessments had not been documented. During the audit, UNDEF developed a checklist for assessment of grantees which included assessment of grantees under categories such as organization vision and goals, structure and staffing, and financial management capacity. The checklist required 'yes' or 'no' answers and comments, if any. However, the checklist did not provide for due diligence screening and determination of suitability of potential partners including criteria for determining whether partners' business practices are unacceptable to the Organization. UNDEF indicated that at the project proposal stage, each applicant was

required to self-certify areas of commitment that include clauses such as: (i) no intent to support violence/terrorism; (ii) aims/purposes conform with the Charter of the United Nations; (iii) the applicant is a duly constituted national/international civil society organization; and (iv) existence of statutes/bylaws for its operations. Further, UNDEF stated that during the initial screening of the long list of project proposals, independent assessors scored each project proposal against 10 set criteria which included some elements of due diligence checks. OIOS noted that apart from the self-declaration by grantees and initial screening by independent assessors which mainly focused on capacity assessments of grantees, UNDEF did not independently conduct and document any due diligence checks. UNDEF needs to document this process before approving individual projects to ensure that the risk to the reputation of the Organization is adequately mitigated.

(1) UNDEF should establish a mechanism to strengthen capacity assessments, as well as adequately conduct and document due diligence checks on each grantee before the approval of projects to mitigate the risk to the Organization's reputation.

UNDEF accepted recommendation 1 and indicated that the recommendation will be implemented by December 2016. Recommendation 1 remains open pending receipt of documentation showing that capacity assessments and due diligence checks on grantees are adequately conducted and documented.

Controls over hiring of independent assessors were adequate

20. The administrative instruction ST/AI/2013/4 on consultants and individual contractors provides guidance on the use of consultants and individual contractors.

21. OIOS reviewed nine independent assessors/consultants engaged by UNDEF in 2014-2015 to assist in the assessment and long listing of project proposals. During 2014, six assessors worked on 2,062 proposals and in 2015, seven assessors worked on 2,331 proposals with an average of 340 proposals per assessor. The consultancies lasted 27 working days and involved a total payment of \$173,724. Each consultant was responsible for assessing a fixed number of project proposals received by UNDEF during the call for proposals process. OIOS review showed that: (i) the consultants were selected based on a documented competitive process; (ii) terms of reference describing their work had been prepared in advance of the engagement; (iii) final evaluations were conducted; and (iv) reports summarizing the strengths and weaknesses of each project proposal from consultants were received. OIOS therefore concluded that controls over the hiring of independent assessors were adequate.

Action was taken to protect the integrity of relevant clauses in project documents

22. Project documents stated that UNDEF should not have a formal relationship with third parties engaged by grantees.

23. UNDEF grantees often used third parties to implement projects. In a sample of 30 projects reviewed, third parties were used in 26 projects. In 23 of the 26 project documents, UNDEF made it clear that it did not consider that it had a formal relationship with third parties and the grantee was responsible for managing financial disbursements related to any implementing agreements concluded between them. Three grantee project documents did not sufficiently clarify the responsibilities of UNDEF towards the third parties. While UNDEF attributed this omission to erroneous deletion of the concerned paragraph from the project document template, the omission could expose UNDEF to third party claims, particularly since its projects had up to 15 third parties in some cases.

24. Furthermore, in 16 cases the grantees did not formally declare whether they intended to solicit co-financing in the implementation of projects. UNDEF confirmed that in all 16 cases there was no co-financing and the declaration provision was deleted in the project document only after the grantee indicated that there was no co-financing. During the audit, UNDEF developed a password-protected template which prevented the deletion of important clauses from the project document. In view of action taken, OIOS did not make a recommendation in this regard.

UNDEF had complied with donor reporting requirements

25. Donor contribution letters and agreements set forth the reporting requirements. During the review period, out of 15 donors, 5 donors had contribution agreements with UNDEF. The remaining 10 donors contributed on the basis of pledges in the form of emails without any reporting requirements. The audit showed that UNDEF complied with the reporting requirements envisaged in the five contribution agreements reviewed.

UNDEF had instituted a mechanism to monitor projects

26. The project document set forth the responsibilities of UNDEF on monitoring of projects. UNDEF used a database to monitor and track the progress of projects at Headquarters. It included information on implementation tracking, negotiations, extensions, post-project extension, financial tracking and milestones.

27. In order to monitor projects at the field level, UNDEF utilized the services of staff members of the United Nations Development Programme in countries where projects were implemented. Independent observers attended activities, observed and collected materials from project events and compiled milestone verification reports for UNDEF. OIOS review of milestone verification reports showed that they included observations, comments and outcomes of the project. OIOS therefore concluded that UNDEF had instituted adequate controls for project monitoring.

Controls over disbursements were satisfactory

28. Grantees were required to submit mid-term progress reports with detailed information on the status of completed activities and those in progress. Financial utilization reports reflecting the amount spent to date were required to be submitted to ensure that at least 70 per cent of the previous tranche had been spent before the next tranche could be disbursed.

29. OIOS reviewed 30 projects with an approved grant amount of \$6.5 million of which \$4 million had been disbursed to grantees. The review showed that disbursements were made on an average in three tranches and payments were received by grantees within 30 days (on average). Disbursements were certified/ approved by authorized officials in accordance with the project document and only after receipt of financial utilization reports showing utilization of at least 70 per cent of previous disbursements. OIOS therefore concluded that internal controls over disbursements were satisfactory.

Unspent balances were processed in accordance with standard operating procedures

30. The standard operating procedures for project closure stated that UNDEF was responsible for operationally closing projects when all activities had been implemented and final documentation was received and reviewed. Projects were financially closed once unspent funds had been returned and financial documentation signed off. Residual balances of less than \$1,000 can be retained by the grantee and not returned to UNDEF in order to minimize transaction costs. Grantees were required to submit a final financial utilization report three months after the project end date.

31. Out of 30 projects reviewed, six projects were closed at the time of the audit. One of these closed projects had an unspent balance amounting to \$9,482 which had been refunded. In three cases, grantees retained the unspent balance because it was less than \$1,000 and in two cases there was no unspent balance. For the six closed projects, financial utilization reports had been submitted by the grantee and a closure checklist highlighting achievements, evaluation findings, performance and financial status was completed by UNDEF. During the closure of projects, UNDEF reviewed the balances spent versus disbursed funds to ensure that any underspend was refunded. A closure letter signed by the Executive Head was sent to the grantee in all six projects after that confirming no funds were due to UNDEF. OIOS therefore concluded that UNDEF had instituted adequate controls to ensure that unspent balances were processed in accordance with standard operating procedures.

Need to formalize a plan for future project evaluations

32. United Nations-funded programmes are generally required to demonstrate results and impact through evaluation of their activities. UNDEF project guidelines required systematic budgeting of funds for evaluation of each project at the rate of 10 per cent of the total budget, subject to a maximum of \$25,000.

33. After following a competitive bidding process, UNDEF signed a contract in 2010 with an external consultancy firm to conduct evaluations of projects. The contract involved an initial commitment of \$2.5 million for two years with an option to extend for three additional one-year periods with a not-to-exceed (NTE) amount of \$5.6 million for five years. In a previous audit (AN2010/524/01), OIOS had stated that the evaluation costs were high and recommended that UNDEF review its evaluation strategy to reduce costs. UNDEF had stated that it would take this into account when considering the extension of the evaluation consultancy contract for future periods. However, UNDEF extended the contract for three additional years and the final extension was awarded up to July 2016 without any changes to the contract price. There was no evidence of negotiations with the vendor to reduce the contract price.

34. In May 2012, UNDEF developed criteria for selective evaluation of projects, instead of evaluating all projects. The external consulting firm had evaluated approximately 40 per cent of closed projects. At the time of the audit, the consultancy firm was paid \$4.6 million for conducting 167 project evaluations with an average cost of \$27,500 per project. Although it is important to demonstrate results and impact through independent review of projects, UNDEF needed to ensure that the evaluation costs are reasonable.

35. UNDEF acknowledged the high overhead costs of commercial evaluations and stated that it would not be renewing the external consultancy firm's contract following its expiration in July 2016. During the audit, the UNDEF Advisory Board agreed with UNDEF's proposal to manage the evaluation processes by establishing a roster of individual, independent external evaluation experts, rather than entering into a bidding process for a new contract with a large commercial firm. UNDEF prepared an evaluation plan for future post-project evaluations whereby it will manage the evaluation process by establishing a roster of individual, independent external evaluation experts for each geographical region where it operates by developing and maximizing local capacity and expertise. UNDEF would conduct up to 10 project evaluations per year based on pre-set criteria at a cost of approximately \$14,000 for each project, as compared to the \$27,500 charged by the consultancy firm previously. However, the evaluation plan was yet to be submitted to the UNDEF Advisory Board for approval. UNDEF stated that it would do this in late 2016.

(2) UNDEF should formalize the plan for future post-project evaluations with the approval of the Advisory Board and institute a mechanism to monitor the costs of project evaluation in future.

UNDEF accepted recommendation 2 and indicated that the recommendation will be implemented by December 2016. Recommendation 2 remains open pending receipt of a formal evaluation plan approved by the Advisory Board and documentation showing that evaluation costs are adequately monitored.

V. ACKNOWLEDGEMENT

36. OIOS wishes to express its appreciation to the management and staff of UNDEF for the assistance and cooperation extended to the auditors during this assignment.

(Signed) Eleanor T. Burns
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Office of Internal Oversight Services

STATUS OF AUDIT RECOMMENDATIONS

Audit of the management of the United Nations Democracy Fund

Rec. no.	Recommendation	Critical ¹ / Important ²	C/ O ³	Actions needed to close recommendation	Implementation date ⁴
1	UNDEF should establish a mechanism to strengthen capacity assessments, as well as adequately conduct and document due diligence checks on each grantee before the approval of projects to mitigate the risk to the Organization's reputation.	Important	O	Receipt of documentation showing that capacity assessments and due diligence checks on grantees are adequately conducted and documented.	31 December 2016
2	UNDEF should formalize the plan for future post-project evaluations with the approval of the Advisory Board and institute a mechanism to monitor the costs of project evaluation in future.	Important	O	Receipt of a formal evaluation plan approved by the Advisory Board and documentation showing that evaluation costs are adequately monitored.	31 December 2016

¹ Critical recommendations address critical and/or pervasive deficiencies in governance, risk management or control processes, such that reasonable assurance cannot be provided with regard to the achievement of control and/or business objectives under review.

² Important recommendations address important (but not critical or pervasive) deficiencies in governance, risk management or control processes, such that reasonable assurance may be at risk regarding the achievement of control and/or business objectives under review.

³ C = closed, O = open

⁴ Date provided by UNDEF in response to recommendations.

APPENDIX I

Management Response

Management Response

Audit of the management of the United Nations Democracy Fund

Rec. no.	Recommendation	Critical ¹ /Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
1	UNDEF should establish a mechanism to strengthen capacity assessments, as well as adequately conduct and document due diligence checks on each grantee before the approval of projects to mitigate the risk to the Organization's reputation.	Important	Yes	Deputy Executive Head, UNDEF	December 2016	
2	UNDEF should formalize the plan for future post-project evaluations with the approval of the Advisory Board and institute a mechanism to monitor the costs of project evaluation in future.	Important	Yes	Deputy Executive Head, UNDEF	December 2016	

¹ Critical recommendations address critical and/or pervasive deficiencies in governance, risk management or control processes, such that reasonable assurance cannot be provided with regard to the achievement of control and/or business objectives under review.

² Important recommendations address important (but not critical or pervasive) deficiencies in governance, risk management or control processes, such that reasonable assurance may be at risk regarding the achievement of control and/or business objectives under review.