



INTERNAL AUDIT DIVISION

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Audit of the arrangements for the audit certification process for implementing partners at the Office of the United Nations High Commissioner for Refugees

There was a critical need for UNHCR to strengthen its quality review mechanisms to mitigate the risk of inappropriate audit opinions and to enhance the assessment of auditors' performance

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Audit of the arrangements for the audit certification process for implementing partners at the Office of the United Nations High Commissioner for Refugees

EXECUTIVE SUMMARY

The Office of Internal Oversight Services (OIOS) conducted an audit of the arrangements for the audit certification process for implementing partners at the Office of the United Nations High Commissioner for Refugees (UNHCR). The objective of the audit was to assess whether UNHCR was implementing and overseeing the audit certification process for implementing partners in an efficient and cost-effective manner in accordance with UNHCR's policy requirements. The audit covered the 2016 and 2017 audit cycles, and included audit work done in 11 UNHCR country operations (Afghanistan, Angola, Djibouti, Lebanon, Libya, Malawi, South Sudan, Syria, Tanzania, Uganda and Zambia), in addition to UNHCR headquarters in Geneva and Budapest. OIOS also undertook a desk review of audited projects in three additional country operations (Iraq, Rwanda and Sudan). The audit covered risk areas related to: (a) administration of the audit engagement process; (b) selection of projects for audit; (c) performance of auditors and quality assurance at UNHCR headquarters; and (d) effectiveness of the risk-based audit policy.

UNHCR had put in place a robust policy framework for risk-based audit of projects, and the centralized procurement of audit firms and the management of the audit certification process had brought some distinct benefits. However, the existing arrangements required further improvements to demonstrate sound stewardship and reasonable use of the entrusted funds. In particular, there was a critical need to strengthen quality review mechanisms to mitigate the risk of inappropriate audit opinions and to enhance the assessment of auditors' performance.

OIOS made one critical and five important recommendations. To address issues identified in the audit, UNHCR needed to:

- Engage auditors, where appropriate, for a minimum of two years in each country to mitigate the risk of frequent change of auditors and further enhance the efficiency and effectiveness of project audits;
- Conduct a general compliance review of global audit fees charged by each audit firm on annual basis at project level prior to or during the competitive bidding process, to ensure that the audit fees are reasonable and appropriate;
- Update the Terms of Reference for the audit of UNHCR funded projects and work with the global audit firms to ensure the consistency of audit reports and that they are aligned with the International Standards on Auditing and select a representative sample for each year and review it for material inconsistencies;
- Better document the criteria and measurements to modify the overall risk tolerance threshold, ensure consistency in the selection of projects to be audited, and incorporate language in the next policy revision to balance costs versus benefits related to the selection process;
- Strengthen the processes over: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors, including in terms of timeliness of audit reports (**critical**); and
- Conduct an in-depth evaluation of the effectiveness of the Policy and Procedures on Risk-Based Project Audit Approach.

UNHCR accepted the recommendations and has initiated action to implement them.

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Audit of the arrangements for the audit certification process for implementing partners at the Office of the United Nations High Commissioner for Refugees

I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of the arrangements for the audit certification process for implementing partners at the Office of the United Nations High Commissioner for Refugees (UNHCR).

2. UNHCR provides funds to partners for undertaking projects on its behalf under a Project Partnership Agreement (PPA). UNHCR is accountable to its stakeholders for the funds spent through partnerships and the sound stewardship of the entrusted funds. Hence, projects implemented by partners are subject to audits performed by external and independent audit service firms (auditors). Under the PPA, UNHCR and partners are required to: establish controls to mitigate risks to project implementation and the achievement of project objectives; ensure proper utilization of funds; and submit project reports, including the Project Financial Report (PFR) reflecting accurate expenditures against the project budget. The PPA also requires partners to maintain relevant project documents and provide access to all information, documents, books, records, transactions, sites, persons and other necessary subjects for audit purposes. It also requires partners to undertake timely and appropriate measures to address and resolve audit observations and recommendations.

3. Projects implemented by governmental partners, non-governmental organizations, academic institutions, Red Cross and Red Crescent Societies and other non-for-profit partners are audited by auditors assigned by UNHCR. Prior to 2015, the arrangements for the audit of projects were undertaken by the respective UNHCR country operation who conducted the procurement of audit services and the selection of projects for audit based solely on their financial value. In 2015, UNHCR issued a revised Policy and Procedures on Risk-Based Project Audit Approach (the Policy) and the related Guidance Note No. 5 on Implementing Partnership Management (the Guidance Note). The Policy aimed at ensuring inter alia that: the quality of audits is improved through centralized selection and contracting of a limited number of qualified auditors following a rigorous selection procedure; the quality of audit reports is consistent and improved; the timeliness of submission of audit reports is improved; due diligence of audit procedures is strengthened through segregation of duties; and the administrative burden on country operations is reduced, while the efficiency of the audit process is enhanced.

4. UNHCR also issued Terms of Reference for Audit of UNHCR-Funded Projects (ToR) in May 2015. The ToR included requirements on: (i) the qualification of auditors and team composition; (ii) the scope of engagements; (iii) the timing of the audit; and (iv) audit deliverables. The ToR also stipulated that the selection of auditors was based on a thorough assessment of qualifications and that the successful auditors would be contracted for a maximum of three to five years under the framework agreement. UNHCR developed a Statement of Work to be signed by the UNHCR Controller and the auditors for the specific annual audit work to be performed.

5. In 2017, UNHCR concluded a total of 1,623 PPAs valued at \$1.42 billion. Of these, 644 PPAs (40 per cent) valued at \$1.04 billion (73 per cent) were subject to an audit. In 2016, UNHCR concluded 1,536 PPAs valued at \$1.26 billion. Of these, 778 (51 per cent) valued at \$921 million (73 per cent) were subject to an audit. The audit fees paid by UNHCR amounted to \$4.76 million for 2016 and \$4.15 million for 2017.

6. The Implementing Partnership Management Service (IPMS), operating under the Controller and Director of the Division of Financial and Administrative Management (DFAM), is responsible for all

matters related to the management of the framework for implementing with partners within UNHCR, formulation of policies, designing procedures, providing guidance, coordination, implementation of strategies, managing UNHCR's Partner Portal, and administering and overseeing the arrangements for audit of projects. As at 30 June 2018, the IPMS was headed by a Chief at the D-1 level and had 15 authorized posts. Since 2015, IPMS has implemented and periodically enhanced various methodologies for project audit, e.g., selection of projects subject to audit, engagement of auditors, quality assurance review, trend analysis, and coordination with country operations, partners and auditors.

7. Comments provided by UNHCR are incorporated in italics.

II. AUDIT OBJECTIVE, SCOPE AND METHODOLOGY

8. The objective of the audit was to assess whether UNHCR was implementing and overseeing the audit certification process for implementing partners in an efficient and cost-effective manner and in accordance with UNHCR's policy requirements.

9. This audit was included in the 2018 risk-based work plan of OIOS due to the risks associated with the external audit of projects implemented by partners using UNHCR funds.

10. OIOS conducted this audit from August to December 2018. The audit covered the 2016 and 2017 audit cycles, and included audit work done in 11 UNHCR country operations (Afghanistan, Angola, Djibouti, Lebanon, Libya, Malawi, South Sudan, Syria, Tanzania, Uganda and Zambia), in addition to UNHCR headquarters in Geneva and Budapest. OIOS also undertook a desk review of audited projects in three additional country operations (Iraq, Rwanda and Sudan).

11. Based on an activity-level risk assessment, the audit covered risk areas related to: (a) administration of the audit engagement process; (b) selection of projects for audit; (c) performance of auditors and quality assurance at UNHCR headquarters; and (d) effectiveness of the risk-based audit policy.

12. The audit methodology included: (a) interviews with key personnel; (b) review of relevant documentation; (c) analytical review of data, including financial data from Managing for Systems, Resources and People (MSRP), the UNHCR enterprise resource planning system, and performance data from Focus, the UNHCR results-based management system; (d) sample testing of controls; and (e) visits to selected UNHCR offices and partners, including review of relevant PFRs and related financial data.

13. The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

III. AUDIT RESULTS

A. Administration of the audit engagement process

There was a need to mitigate the risks related to frequent change of auditors

14. Prior to the new Policy, each UNHCR country operation had contracted audit firms on a single contract basis which resulted in UNHCR having hundreds of audit firms without proper global coordination. IPMS indicated that there were weaknesses in the procurement process and recording of audit fees against the appropriate budget line. There was also no proper tracking of the changes of the project type, auditor's profile and performance, and quality assessment, which were necessary for audit selection. The new centralized procurement of audit firms in 2015 was introduced to address these issues.

15. UNHCR selected and entered into a framework agreement with three international and one regional audit firm to conduct audits of selected projects for three years commencing with the 2014 audit cycle. In 2017, the framework agreements were extended for two additional years. During this period, the annual appointment of auditors to the individual projects was done through a competitive “mini-bidding” process.

16. In 65 country operations, where there were audits each year in 2015, 2016 and 2017, 13 had the same auditor for the three-year period, and in 26 country operations, the same auditors stayed for two years within the three-year period. However, in the remaining 26 country operations there was no continuity of auditors, i.e., each year a different auditor performed the audit. In one country operation, for example, there were different auditors each year for the past four years.

17. In five country operations visited by OIOS, the Representations were of the view that the incoming auditors’ insufficient knowledge of the UNHCR regulatory framework and the operating environment was an impediment to an effective audit. They also commented that it would be more practical for the same firm to conduct audits for two or three consecutive years to allow them to build up institutional memory rather than starting afresh every year. This observation was supported by the results of a survey conducted by IPMS as well as the views of the audit firms themselves during OIOS’ discussions with them. The auditors indicated that it would be advantageous to stay at least for two years in the same country for the following reasons: (i) the “mini-bidding” process was time consuming; (ii) the audits required significant investment from auditors every year; for example, in the form of training team members and developing audit working papers; (iii) auditors would better understand the operational context and the projects if they would stay for at least one more year, which would lead to better quality audit work as the learning curve progresses in the second year; and (iv) continuity would increase the possibility to detect fraud.

18. IPMS, however, considered the non-rotation of auditors as a risk and took actions to avoid that risk in the 13 country operations where the same auditor stayed for three years from 2015 to 2017. Actions taken in this regard included the re-designation of one auditor’s status from a regional to a global audit firm to increase competition, and seeking approval of the Committee on Contracts at UNHCR headquarters for mandatory rotation of auditors. Whilst acknowledging that IPMS was concerned about the risk of familiarity that could arise from non-rotation of auditors, OIOS was of the view that the risks from lack of continuity of auditors and the potential benefits from engaging them for two years or more also needed to be considered. These questions needed to be looked at holistically to optimize the efficiency and effectiveness of the project audit certification process.

(1) The UNHCR Division of Financial and Administrative Management should engage auditors, where appropriate, for a minimum of two years in each country in order to mitigate the risk of frequent change of auditors and further enhance the efficiency and effectiveness of project audits.

UNHCR accepted recommendation 1 and stated that it would provide OIOS with documentary evidence of: (i) the results of the global review of audit engagements; and (ii) the management review undertaken on the results of the global review and consequent management decisions made, as necessary, when mitigation measures need to be made to address the risk of frequent changes of auditors. Recommendation 1 remains open pending receipt of documentary evidence of: (i) the results of global review of audit engagements; and (ii) the management review undertaken on the results of the global review and consequent decisions on the required mitigation measures.

There was a need to establish an internal benchmark to measure the reasonableness of audit fees and ensure effective competition among audit firms

19. The preparation of an estimate for a service contract's potential cost serves as a tool throughout the process of planning for and awarding the contract. The purpose of such an estimate is to develop an assessment of the probable total cost of services being acquired and to help determine the reasonableness of an offeror's proposed costs. Best practices in procurement also recommend a market survey to be conducted to determine the extent of competition and capabilities available. Similar to other services, audit services have their own market price. Unless there are significant changes in the characteristics of the given project, audit fees should not increase significantly from year to year.

20. For the procurement of audit services under the framework agreements with audit firms signed in 2014 and ending in 2019 (three years original plus two years of extension), UNHCR had conducted a procurement exercise worldwide, which saw 22 audit firms submit bids. UNHCR selected four firms as per the UNHCR procurement procedures. A re-bid was planned to be undertaken for the 2019 audit cycle.

21. The Statement of Work set out the agreed rates for each of the auditors. However, IPMS had not established an internal benchmark in relation to audit fees. Whilst IPMS had conducted an analysis of audit fees for 2014-2018, this was done only at geographical group level (IPMS clustered the country operations into 21 geographical groups) and not at PPA/project level. Furthermore, the analysis did not include conclusions or follow up actions. In the view of OIOS, IPMS had sufficient information about all the characteristics of the projects, i.e. volume, risks and complexity, as well as the partners' history with UNHCR and adequacy of their control frameworks. Therefore, it could have undertaken an analysis of the historical data on audit fees together with the characteristics of the projects and partners. This would have enabled it to establish an internal benchmark for audit fees.

22. In the absence of a benchmark, there were some unusual trends in the audit fees. For example, in one country the audit fees for eight PPAs had increased by 40 per cent from 2016 to 2017, including in one project where the audit fee had increased by 124 per cent even though the budget for the PPA had decreased. In another project in the same country operation, the budget increased by 332 per cent from \$3.7 million in 2016 to \$16.0 million in 2017, but the audit fees declined by 70 per cent. In another country operation, the audit fees for 10 PPAs had increased by an average of 92 per cent from 2016 to 2017, with no documented explanation. Most notably, the audit fee for four PPAs had increased between 38 and 146 per cent despite a decrease in project budgets ranging from 26 to 53 per cent.

23. Under the ToR, the number of auditors in the audit team may vary according to the audit subject, volume and size of the projects being audited. OIOS analyzed the audit fees in 2017 in five country operations and noted different pricing approaches. In two of these operations, the audit fees were proportionate to the project budget and hours spent by auditors. However, in two other countries, auditors applied flat audit fees for each project; therefore, the fees were not proportionate to the budget or to the hours spent on the projects. Also, in some cases, although audit fees were not flat rates they were not proportionate to the budgets or to hours spent on the audits. For example, in one country the auditor reported the same number of hours spent on each project regardless of whether the audit fee was \$8,200 or \$12,300.

24. OIOS undertook a holistic analysis of the number of PPAs and the related costs over the four-year period from 2014 to 2017. The analysis showed a steady decline in the number of PPAs audited and the total audit fees. However, it also showed a constant increase in the average audit fees per PPA. Although the number of audited PPAs decreased by 31 per cent since 2014, the audit fees decreased only by 18 per cent. During the same period, the average audit fee per project increased by 18 per cent which indicated an increase over a four-year period of approximately \$1,000 per PPA.

25. OIOS also analyzed the “mini-bidding” process conducted in 2016 and 2017 and found that in 2016 only two auditors had provided a price offer for all the PPAs, while the other two auditors provided bids only for 46 and 22 per cent, respectively, of the projects. Therefore, for 336 PPAs in 60 country operations IPMS received bids only from two auditors. In 2017, the situation improved after a regional auditor’s status had changed to global, and this firm gave an offer for all PPAs. Consequently, in 2017, three auditors provided bids for the full set of projects. However, one auditor only provided an offer for 50 per cent of the PPAs. This resulted in limited competition and might have led to higher audit fees.

26. OIOS was also concerned about the inherent risk of cartels and possible behind-the-scenes collaboration between the auditors on the audit fees. This risk needed to be better addressed, including by ensuring that the actual audit expenditures are cost efficient. An analysis of the historical audit fees would be one means of helping UNHCR establish an internal benchmark for audit fees of each project, evaluate the reasonableness of the bids, and negotiate with the auditors on the audit fees.

27. IPMS stated that costs were governed by various factors including prevailing market prices, competition, access, geographical coverage, economies of scale, operating conditions, security at a given time, and feasibility on how to obtain the ideal costs. OIOS is of the view that even though audit fees depended on many factors, establishing an internal benchmark and monitoring audit fees at the project level could lead to cost efficiencies.

(2) The UNHCR Division of Financial and Administrative Management should conduct a general compliance review of global audit fees charged by each audit firm on annual basis at project level prior to or during the competitive bidding process, to ensure that the audit fees are reasonable and appropriate.

UNHCR accepted recommendation 2 and stated that it would provide OIOS with documentary evidence of the compliance review conducted before or at the time of the additional layer of competitive bidding for specific audit assignments (“mini bidding”). Recommendation 2 remains open pending receipt of evidence that a general compliance review has been conducted by DFAM of global audit fees charged by each audit firm on annual basis at project level, prior to or during the competitive bidding process, to ensure that the audit fees are reasonable and appropriate.

There was a need to update the existing ToR in line with the International Standards on Auditing and ensure consistency in the structure and content of the audit reports

28. The Policy states that the conduct of the audit and the format and content of the audit report need to be in accordance with the International Standards on Auditing (ISAs). The ToR lays out the terms and conditions of a project audit and the engagement of auditors including the template of Independent Auditor’s Report (audit report). Further, the ToR specifically requires the auditors to declare that the audit was conducted in accordance with the ISAs.

29. The following provisions in the ToR were outdated or not in accordance with the ISAs:

- A new audit report template had been prescribed by the Independent Auditing and Assurance Standards Board (IAASB) for implementation of audits starting 15 December 2016. It was also to be used by auditors in UNHCR project audits. However, the old template prescribed in the ToR was not revised in line with the new IAASB template.
- The ToR specifically mentioned the ISA numbers 700, 701, 705, 706, 800 but excluded ISA 805 (Revised) (Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement) which was the most relevant ISA for the audit of PFR, a single financial statement.

- The auditors followed the ToR requirement to conclude and rate internal controls as satisfactory, partially satisfactory, and unsatisfactory. OIOS noted that this was unusual as the application of ISAs did not require auditors to conclude and rate on the adequacy and effectiveness of the internal control system. Rather, the ISAs required auditors to evaluate the internal control system as the basis for designing substantive tests for the accounts in the financial statements, in this case the PFR.

30. OIOS also reviewed the structure and content of the audit reports and identified the following shortcomings:

- There was inconsistency in the language used in the opinion paragraph of the audit reports. Three auditors used “have been prepared in accordance with financial reporting framework”, while one auditor used “present fairly in accordance with financial reporting framework” which was in line with the ISA requirements.
- The addressees were inconsistent, i.e., one auditor addressed the audit reports to IPMS while the other three auditors addressed them to the Head of Office/Representative as required by the ToR.
- In the opinion section of the audit reports, reference to the notes to PFR was made by one auditor but not by the other three.
- Two auditors mentioned ‘modified cash basis of accounting’ as the accounting policy applied, while the other two mentioned ‘cash basis of accounting’ and ‘cash receipts and disbursements basis’ respectively.
- The emphasis of matter section of the audit reports was inconsistent. One auditor indicated the basis of accounting and the restriction on distribution and use of the audit report while the others did not, and two auditors included financial findings in the reports although they should have been reported in the management letter instead.
- There was inconsistency in the section on the auditor’s responsibilities, i.e., only one among the four auditors indicated ISA 805 provisions on (a) identifying and assessing the risks of material misstatement of the PFR, (b) obtaining an understanding of internal control relevant to the audit, (c) evaluating appropriateness of accounting policies and reasonableness of accounting estimates, and (d) concluding on the appropriateness of management’s use of the going concern basis of accounting, while the other auditors did not.

31. OIOS is of the opinion that UNHCR was not sufficiently ensuring that the audits were conducted in accordance with the ISAs due to numerous inconsistencies in the audit reports as discussed above. IPMS agreed to update the ToR but emphasized that the auditors had a different interpretation of ISAs and applied them differently.

(3) The UNHCR Division of Financial and Administrative Management should: (i) update the Terms of Reference for the audit of UNHCR funded projects and work with the global audit firms to ensure the consistency of audit reports and further that they are aligned with the International Standards on Auditing; and (ii) select a representative sample for each year and review it for material inconsistencies.

UNHCR accepted recommendation 3 and stated that it had provided OIOS with documentary evidence of the updated ToR of audit firms referencing ISA 805 and would further provide the results of the review of a sample of audit reports including any material variances in quality and consistency found in the sample that were duly transmitted to the auditors. Recommendation 3 remains open pending receipt of evidence of the results of review of a representative sample of audit reports including any material variances in quality and consistency found in the sample that were transmitted to the auditors.

B. Selection of projects

There was a need to strengthen the project selection criteria and streamline the selection process

32. The Guidance Note requires that projects subject to audit are annually assessed and ranked by IPMS through a composite of risk criteria. It also stipulates that: (i) all projects implemented by new partners are audited in their first year of operation regardless of their project risk ranking; (ii) all partners are covered at least once in every four-year operational cycle; and (iii) an opportunity is given to UNHCR field offices, Bureaux and Divisions to recommend additional projects for audit, which they may deem necessary.

33. OIOS noted the following weaknesses in the selection of the PPAs subject to audit:

- 58 projects (\$6.9 million) in 2016 and 102 projects (\$5.4 million) in 2017 were not selected for audit, although they were implemented by new partners. It was unclear whether the term “new partners” under the Guidance Note meant partners that were new to the given country operation, business unit or UNHCR worldwide. Furthermore, in 2016, 30 projects were not selected for audit while 101 projects were not selected in 2017 although the partners in question had not been audited in a four-year period. The value of these unaudited projects was \$9.6 million.
- The overall risk tolerance threshold was not respected. It was established at 2.7 in 2014 and 2015, at 2.8 in 2016, and at 3.0 in 2017. However, 68 projects valued at \$94 million with a risk rating equal to or higher than 2.8 were not selected for audit in 2016, and four projects with a risk rating equal to or higher than 3.0 were not selected in 2017. IPMS informed OIOS that only projects with non-significant budgets were left out from the selection; however, OIOS noted that these included five projects with budgets of over \$4 million. OIOS was of the view that the overall risk tolerance threshold should have been respected regardless of the size of the projects as even a small project could cause reputational risks to UNHCR.
- OIOS was not convinced about the rationale behind increasing the overall risk tolerance threshold (and the resultant decrease in the number of PPAs selected for audit). According to IPMS, the overall threshold simply oscillated within a narrow range of 2.7-3.0, and the reason for increasing the risk threshold from year to year was its internal assessment related to the improvements in the prevailing conditions, such as management of projects, field monitoring and verifications of projects during the implementation year, as well as the quality of audits and audit results. OIOS was of the opinion, based on its own audit work on numerous UNHCR field operations, that certain aspects of partnership management such as partner selection had improved, notably as a result of increased number of Project Control Officers and provision of additional training and guidance by IPMS, but recurrent issues in partner monitoring, partner procurement and timely signature of PPAs still persisted, as systematically reported in OIOS annual reports to UNHCR Executive Committee for the years from 2014 to 2017. IPMS added that several risk tolerance threshold scenarios were presented to the Controller, and his/her judgement was based on consideration of different factors, including assessed risks, experience from the previous years, feedback received, and cost effectiveness. However, OIOS was still of the view that the criteria for changing the overall risk tolerance threshold had not been clearly defined, and the reason for increasing the threshold from 2016 to 2017 was not based on a full consideration of the risk and control environment.
- There were inconsistencies in sense checks from year to year. For example, in 2016 IPMS excluded projects with higher risk rate than 2.8, what it called a positive reward, because the partners concerned had obtained an unmodified opinion over the previous four years or had maintained very good internal controls. In 2017, no such a positive discrimination was applied. OIOS also noted

that four projects (for a total of \$22.8 million), which had a budget exceeding \$5 million each were not selected for audit in 2016. In contrast, in 2017, all projects with a budget over \$5 million were selected for audit. IPMS informed OIOS that sense checks varied depending on the Controller's requests from year to year. In the opinion of OIOS, the sense checks needed to be more clearly defined and more consistent.

- The selection procedure was complex and required significant resources. IPMS was of the view that the selection methodology applied was a very good guide for decision making and was not supposed to be mechanically applied. However, OIOS noted that the process required a lot of time spent in the selection whereas in the end, the selection of PPAs subject to audit depended on the approved threshold, and the benefits might not be proportionate to the related efforts and costs.
- The selection criteria had not fully taken into consideration the results of the financial verifications performed by the Project Control Units (PCUs) in country operations. The Representations had the opportunity to request an audit of any project, if the results of the PCU verifications for the same project showed significant deficiencies; however, OIOS could not find evidence that this practice was frequently applied. OIOS was of the view that the consideration of the PCU reviews could be better institutionalized during the selection process, to ensure that risks and gaps as highlighted in PCU reports are factored into the selection criteria.

34. The issues cited above were due to inconsistent application of the established selection procedures. In OIOS' opinion, there had been too many deviations from the Guidance Note, the rationale of which was not always clear and some of which had not been properly documented. Therefore, the risk of inappropriate selection of projects for audit or exclusion of projects from audit remained unmitigated.

(4) The UNHCR Division of Financial and Administrative Management should: (i) better document the criteria and measurements to modify the overall risk tolerance threshold; (ii) ensure consistency based on documented criteria in the selection of projects to be audited to ensure they meet the requirements of the UNHCR Policy and Procedures on Risk-Based Project Audit Approach, while maintaining management's discretion for flexibility with reasonable justification; and (iii) incorporate language in the next policy revision to balance costs versus benefits related to the selection process.

UNHCR accepted recommendation 4 and stated that it has updated the methodology for the selection of projects subject to audit. It has also documented the criteria and measurements for the overall risk threshold level for the 2018 audit cycle and made arrangements to automate the process for greater efficiency. UNHCR would: (i) provide OIOS with documentary evidence regarding the documentation of the criteria and measurements to modify the overall risk tolerance threshold for the 2019 audit cycle; (ii) ensure consistency based on documented criteria in the selection of projects; and (iii) incorporate language in the next policy revision to balance costs versus benefits related to the selection process. The policy revision would be due by 31 December 2021, however, the actual revision may take place before that date. Recommendation 4 remains open pending receipt of: (i) documentation of the criteria and measurements to modify the overall risk tolerance threshold for the 2019 audit cycle; (ii) evidence of ensuring consistency based on documented criteria in the selection of projects to be audited to ensure they meet the requirements of the UNHCR Policy and Procedures on Risk-Based Project Audit Approach; and (iii) the revised policy incorporating provisions to balance costs versus benefits related to the selection process.

C. Quality assurance

There was a critical need to mitigate the risk of inappropriate audit opinions and strengthen the process of assessing the auditors' performance

35. The performance of auditors, quality of audit reports, and auditors' compliance with the contractual terms is assessed by UNHCR, United Nations Board of Auditors and OIOS to ensure appropriate audit opinion is rendered on the PFRs while providing UNHCR reasonable assurance on the fairness of presentation of the PFR. To render an audit opinion, auditors are required to undertake a risk assessment, perform tests related to the items in the Internal Control Questionnaire template and conduct substantive audit procedures on the fair presentation of the accounts in the PFR. The Terms of Reference for Quality Assessment of Project Audit Certification (ToRQA) require IPMS to perform a quality review to: (i) corroborate that the project audit certifications are accurate, relevant, complete, timely and consistent; and (ii) provide recommendations for improving financial operations and management controls. To assess auditors' performance, IPMS established four key performance indicators (KPIs): (i) timeliness of the audit; (ii) audit quality in accordance with the ISAs; (iii) survey results obtained from UNHCR field offices on the performance of the auditors; and (iv) team composition (introduced in 2017).

(a) Need to reduce the risk of inappropriate audit opinions being rendered

36. OIOS reviewed 57 audit reports in 11 country operations and was of the view that for 14 audit reports pertaining to five country operations, the audit opinion rendered by the project auditors may not have been warranted given the significant or pervasive issues observed by OIOS (which were not reported by the project auditors). These included: (a) inaccurate payments of project headquarters support costs (PHSC) totalling \$112,140 in eight PPAs in three country operations; (b) human resource issues including absence of employment contracts and substantial differences between remuneration figures in the project budgets and the amounts paid to partner staff in 11 PPAs in four country operations; (c) variations aggregating to \$782,310 between partners' general ledgers and the PFRs in one operation for four partners; (d) significant procurement shortcomings at partners in four country operations in respect of 10 PPAs, including: deviations from frame agreements; non-competitive selection of vendors; inability to ensure value for money; lack of clarity in technical specifications; exclusion of valid bids on financial and technical grounds; inconsistent use of mandatory criteria thereby excluding eligible vendors; non-award of contracts to the lowest bidder; and practice of submitting corrected bids; (e) questionable expenditure related to official travel, and misclassification of expenses in the general ledger; and (f) questionable purchase and use of fuel, questionable purchase of land, and unsupported payments of allowances.

37. OIOS also conducted a desk review of the audit opinions, PCU verification results and financial information in the PFR in eight country operations. For 22 of the 107 audit reports reviewed, the issues raised by the PCUs supported OIOS' conclusions that the auditors may not have considered significant weaknesses at the partners in reaching their opinion, including: (a) procurement shortcomings such as inadequate documentation and uneconomic procurement; (b) unreconciled account balances between the general ledger and PFRs; (c) unsupported payments of salary, overtime, incentives and fuel charges; and (d) overpayments of PHSC. In addition, OIOS observed that in eight PPAs, the auditors raised material or pervasive findings in the management letter, without modifying the auditor's report.

38. OIOS therefore concluded that an 'audit risk' existed in that the auditors could have expressed inappropriate audit opinions in some situations where the PFRs could have actually been materially misstated.

(b) Performance assessment of the auditors needed strengthening

39. The ToRQA required IPMS to assess the auditors' performance through a series of desktop reviews which included the review of auditors' working papers. IPMS adopted the practice of selecting all projects with modified opinions and five per cent of the projects with unmodified opinion for quality review. OIOS assessed that this gave significantly higher weight to projects with modified opinions, since the selected samples were not representative of the whole population of audit reports. IPMS informed OIOS that all projects with modified opinion were selected for quality review because the Representations and partners had requested it. However, OIOS was of the view that the risk of inappropriate audit opinion existed for all projects audited regardless of the type of opinion rendered by the auditors. Therefore, equal chance should have been given to each audit report for quality review.

40. UNHCR's target was to have 20 per cent of the audits completed by 31 March 2018, and only 13 per cent were completed by the deadline. Whilst UNHCR required all audits to be completed by 30 April 2018, only 68 per cent were completed by this deadline. In addition, whereas deadlines were established for the final deliverables, clear and measurable criteria for auditors to achieve "satisfactory" performance had not been defined. It was therefore unclear how all four auditors had obtained satisfactory ratings, considering that 32 per cent of the audits were not finalized by the deadline in the 2017 audit cycle, and 18 per cent in the 2016 audit cycle. It is noteworthy to mention that the Board of Auditors had qualified its opinion on the financial statements of UNHCR for 2008 because the audit of 50.2 per cent of the projects' budget subject to audit had not been finalized by 10 July 2009. IPMS informed OIOS that the timeliness of the audit reports had been improved in the last four years and the delays were not caused by auditors, but by partners submitting the PFRs late. OIOS acknowledges that IPMS had made efforts to track timeliness of reporting, solve bottlenecks, and review cases where operational requirements necessitated extensions in report submission. However, and notwithstanding the delays on the part of the partners that represented a risk of its own, OIOS was of the view that clear and measurable criteria were needed to appropriately measure the performance of the auditors on timeliness of their work.

41. In cases the satisfactory rating given to the four partners was questionable considering the numerous negative comments from the respondent UNHCR Representations and partners. For example, one auditor in 2017 received unsatisfactory ratings from 10 per cent of the partners and 28 per cent of the Representations; and another auditor in 2016 received unsatisfactory ratings from 9 per cent of the partners to the question about whether they demonstrated a reasonable understanding of the office and operational context. IPMS did not have a follow-up arrangement to dispose of substantive comments provided in the survey. Although IPMS informed OIOS that throughout the process there had been a fluid communication with Representations and auditors of issues raised in the surveys and emerging situations were handled immediately, OIOS did not receive evidence of those actions.

42. For the KPI that IPMS had developed to measure the qualification and team composition of the auditors, it assessed the information based on: (i) leadership and engagement of the audit firm's headquarters; (ii) composition of the team; (iii) qualification and experience of the principal auditor or team leader; and (iv) experience in ISAs and in auditing entities of comparable size and complexity to the entity being audited. OIOS noted however that IPMS had not taken into consideration other factors required by the ToRQA, such as past experience drawn from previous audits conducted and feedback obtained from various UNHCR field offices and partners. OIOS also found that Representations had not received any information about the audit team members before the audit field work started; therefore, they did not have the opportunity to verify the profile of the auditors and whether they belonged to the audit firm. IPMS informed OIOS during the audit that more than 90 per cent of the information about team composition had been confirmed with Representations and appeared to be accurate. OIOS was of the view that the team composition should ideally be communicated to the Representations at the outset of the audit.

43. As a result of the cited shortcomings, UNHCR was not adequately ensuring that good quality audit reports were delivered in a timely manner and that the monitoring mechanisms over the assessment of auditors' performance were fully effective.

(5) The UNHCR Division of Financial and Administrative Management should strengthen the processes over: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors, including in terms of timeliness of audit reports.

UNHCR accepted recommendation 5 and stated that the ToRQA of the Audit Process/KPIs and the selection methodology for the review sample had been revised. The auditors' consideration of the PCU's verification reports and feedback from Field Offices are included in the assessment. In order to demonstrate implementation of this recommendation, UNHCR would provide OIOS with evidence that it has strengthened the processes over: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors. Recommendation 5 remains open pending receipt of evidence of: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors, including in terms of timeliness of audit reports.

D. Effectiveness of the risk-based audit policy

There was a need to formally evaluate the effectiveness of the risk-based audit policy

44. The Policy indicates that it is to be reviewed every three years or earlier as necessary to ensure adequacy of the methodology, and to realize more efficient, productive and effective audits.

45. IPMS had not conducted a formal and holistic evaluation on the effectiveness of the Policy three years after its promulgation in 2015. During the audit fieldwork, IPMS informed OIOS that it had requested the UNHCR Organizational Development and Management Service for the continued implementation of the Policy and an extension of the review period after its expiration in May 2018. In June 2019, IPMS provided evidence of the approved extension of the policy up to 31 December 2021. Whilst OIOS assessed that the policy framework for risk-based audit of projects was robust by design, there were issues in its actual implementation, as confirmed by this audit, that needed to be addressed also in the Policy.

(6) The UNHCR Division of Financial and Administrative Management should formally conduct an in-depth evaluation of the effectiveness of the Policy and Procedures on Risk-Based Project Audit Approach.

UNHCR accepted recommendation 6 and stated that it would provide OIOS with a report of an in-depth review of the Policy to be implemented for 2019 partnership audits. Recommendation 6 remains open pending receipt of evidence of the results of the in-depth evaluation of the Policy for the 2019 partnership audits.

IV. ACKNOWLEDGEMENT

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

(Signed) Eleanor T. Burns
Director, Internal Audit Division
Office of Internal Oversight Services

STATUS OF AUDIT RECOMMENDATIONS

**Audit of the arrangements for the audit certification process for implementing partners at
the Office of the United Nations High Commissioner for Refugees**

Rec. no.	Recommendation	Critical ¹ / Important ²	C/ O ³	Actions needed to close recommendation	Implementation date ⁴
1	The UNHCR Division of Financial and Administrative Management should engage auditors, where appropriate, for a minimum of two years in each country in order to mitigate the risk of frequent change of auditors and further enhance the efficiency and effectiveness of project audits.	Important	O	Submission to OIOS of: (i) the results of global review of audit engagements; and (ii) the management review undertaken on the results of the global review and consequent decisions on the required mitigation measures.	31 March 2020
2	The UNHCR Division of Financial and Administrative Management should conduct a general compliance review of global audit fees charged by each audit firm on annual basis at project level prior to or during the competitive bidding process, to ensure that the audit fees are reasonable and appropriate.	Important	O	Submission to OIOS of evidence that a general compliance review has been conducted by DFAM of global audit fees charged by each audit firm on annual basis at project level, prior to or during the competitive bidding process, to ensure that the audit fees are reasonable and appropriate.	31 December 2019
3	The UNHCR Division of Financial and Administrative Management should: (i) update the Terms of Reference for the audit of UNHCR funded projects and work with the global audit firms to ensure the consistency of audit reports and further that they are aligned with the International Standards on Auditing; and (ii) select a representative sample for each year and review it for material inconsistencies.	Important	O	Submission to OIOS of evidence of the results of review of a representative sample of audit reports including any material variances in quality and consistency found in the sample that were transmitted to the auditors.	31 December 2020
4	The UNHCR Division of Financial and Administrative Management should: (i) better document the criteria and measurements to modify the overall risk tolerance threshold; (ii) ensure consistency based on documented criteria in the selection of projects to be audited to ensure they meet the requirements of the UNHCR Policy and Procedures on Risk-Based Project Audit Approach, while maintaining management's discretion for	Important	O	Submission to OIOS of: (i) documentation of the criteria and measurements to modify the overall risk tolerance threshold for the 2019 audit cycle; (ii) evidence of ensuring consistency based on documented criteria in the selection of projects to be audited to ensure they meet the requirements of the UNHCR Policy and Procedures on Risk-Based	31 December 2020

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 UNHCR in response to recommendations. Implementation date given by the client.

STATUS OF AUDIT RECOMMENDATIONS

**Audit of the arrangements for the audit certification process for implementing partners at
the Office of the United Nations High Commissioner for Refugees**

Rec. no.	Recommendation	Critical ¹ / Important ²	C/ O ³	Actions needed to close recommendation	Implementation date ⁴
	flexibility with reasonable justification; and (iii) incorporate language in the next policy revision to balance costs versus benefits related to the selection process.			Project Audit Approach, and (iii) the revised policy incorporating provisions to balance costs versus benefits related to the selection process.	
5	The UNHCR Division of Financial and Administrative Management should strengthen the processes over: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors, including in terms of timeliness of audit reports.	Critical	O	Submission to OIOS of: receipt of evidence of: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors, including in terms of timeliness of audit reports.	31 December 2020
6	The UNHCR Division of Financial and Administrative Management should formally conduct an in-depth evaluation of the effectiveness of the Policy and Procedures on Risk-Based Project Audit Approach.	Important	O	Submission to OIOS of evidence of the results of the in-depth evaluation of the Policy for the 2019 partnership audits.	31 December 2020

APPENDIX I

Management Response

Management Response

**Audit of the arrangements for the audit certification process for implementing partners at the
Office of the United Nations High Commissioner for Refugees**

Rec. no.	Recommendation	Critical ¹ / Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
1	The UNHCR Division of Financial and Administrative Management should engage auditors, where appropriate, for a minimum of two years in each country in order to mitigate the risk of frequent change of auditors and further enhance the efficiency and effectiveness of project audits.	Important	Yes	Head, Implementing Partnership Management Service	Q1 2020	UNHCR accepts the recommendation and will provide OIOS with documentary evidence of: (i) the results of the global review of audit engagements; and (ii) the management review undertaken on the results of the global review and consequent management decisions made, as necessary, when mitigation measures need to be made to address the risk of frequent changes of auditors.
2	The UNHCR Division of Financial and Administrative Management should conduct a general compliance review of global audit fees charged by each audit firm on annual basis at project level prior to or during the competitive bidding process, to ensure that the audit fees are reasonable and appropriate.	Important	Yes	Head, Implementing Partnership Management Service	Q4 2019	UNHCR accepts the recommendation and will provide OIOS with documentary evidence of the compliance review conducted before or at the time of the additional layer of competitive bidding for specific audit assignments (“mini bidding”).
3	The UNHCR Division of Financial and Administrative Management should: (i) update the Terms of Reference for the audit of UNHCR funded projects and work with the global audit firms to ensure the consistency of audit reports and further that they are aligned with the International Standards on Auditing; and (ii) select a	Important	Yes	Head, Implementing Partnership Management Service	Q4 2020	UNHCR accepts the recommendation and provided OIOS with documentary evidence of the updated ToRs of audit firms referencing ISA 805; and would further provide the results of the review of a sample of audit reports including any material variances in quality and consistency found in the sample that were duly transmitted to the auditors.

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.

Management Response

**Audit of the arrangements for the audit certification process for implementing partners at the
Office of the United Nations High Commissioner for Refugees**

Rec. no.	Recommendation	Critical ¹ / Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
	representative sample for each year and review it for material inconsistencies.					
4	The UNHCR Division of Financial and Administrative Management should: (i) better document the criteria and measurements to modify the overall risk tolerance threshold; (ii) ensure consistency based on documented criteria in the selection of projects to be audited to ensure they meet the requirements of the UNHCR Policy and Procedures on Risk-Based Project Audit Approach, while maintaining management's discretion for flexibility with reasonable justification; and (iii) incorporate language in the next policy revision to balance costs versus benefits related to the selection process.	Important	Yes	Head, Implementing Partnership Management Service	Q4 2020	UNHCR accepts the recommendation and states that UNHCR has updated the methodology for the selection of projects subject to audit. UNHCR has also documented the criteria and measurement for the overall risk threshold level for the 2018 audit cycle and made arrangements to automate the process for greater efficiency. UNHCR will: (i) provide OIOS with documentary evidence regarding the documentation of the criteria and measurements to modify the overall risk tolerance threshold for the 2019 audit cycle; (ii) ensure consistency based on documented criteria in the selection of projects; and (iii) incorporate language in the next policy revision to balance costs versus benefits related to the selection process. The policy revision is due by 31 December 2021, however, the actual revision may take place before that date.
5	The UNHCR Division of Financial and Administrative Management should strengthen the processes over: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors, including in terms of timeliness of audit reports.	Critical	Yes	Head, Implementing Partnership Management Service	Q4 2020	UNHCR accepts the recommendation and states that the ToR for the Quality Assessment of the Audit Process/Key Performance Indicators and the selection methodology for the review sample have been revised. The auditors' consideration of the Project Control Unit's verification reports and feedback from Field Offices are included in the assessment. In order to demonstrate implementation of this recommendation, UNHCR will provide OIOS

Management Response

Audit of the arrangements for the audit certification process for implementing partners at the Office of the United Nations High Commissioner for Refugees

Rec. no.	Recommendation	Critical ¹ / Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
						with evidence that it has strengthened the processes over: (i) the quality review of the appropriateness of the opinion in the auditors' reports; and (ii) the assessment of the performance of auditors.
6	The UNHCR Division of Financial and Administrative Management should formally conduct an in-depth evaluation of the effectiveness of the Policy and Procedures on Risk-Based Project Audit Approach.	Important	Yes	Head, Implementing Partnership Management Service	Q4 2020	UNHCR accepts the recommendation and will provide OIOS with a report of an in-depth review of the Policy to be implemented for 2019 partnership audits.