



INTERNAL AUDIT DIVISION

AUDIT REPORT 2013/025

Audit of UN-Habitat Pakistan Office

Overall results relating to efficiency and effectiveness of the implementation of UN-Habitat programme in Pakistan were partially satisfactory. Implementation of three important recommendations remains in progress.

FINAL OVERALL RATING: PARTIALLY SATISFACTORY

25 March 2013

Assignment No. AA2012/250/02

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AUDIT REPORT

Audit of UN-Habitat Pakistan Office

I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of the United Nations Human Settlements Programme (UN-Habitat) Pakistan Office.
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 UN General Assembly to promote socially and environmentally sustainable towns and cities with the goal of providing adequate shelter for all.
4. UN-Habitat Pakistan worked in the field of basic services, housing, community infrastructure, urban development and disaster risk management. The Office's field operations were based on community led development, in which affected populations participated in their recovery, rehabilitation and development. As at 31 July 2012, UN-Habitat was implementing 13 projects with budgeted expenditure of \$57.4 million, of which \$44.6 million was on a single project on settlements flood recovery across Pakistan.
5. The UN-Habitat Office in Pakistan is overseen by Regional Office for Asia and the Pacific (ROAP) in Fukuoka, Japan, which is under the Project Office at the UN-Habitat Headquarters in Nairobi, Kenya. At the peak of its operations in 2011, UN-Habitat Pakistan had offices in Islamabad, Lahore, Karachi, Quetta and Mardan as well as 12 field offices throughout Khyber Pakhtunkhwa, Baluchistan, Sindh and Punjab provinces. As at 24 September 2012, the Office had 25 staff members comprising two international staff members, one international United Nations Volunteer and 22 national staff members. In addition, the Office had a contract with a local vendor who provided 209 staff for social mobilization, sub-engineering and other operational activities.
6. Comments provided by UN-Habitat are incorporated in *italics*.

II. OBJECTIVE AND SCOPE

7. The audit of UN-Habitat Pakistan Office was conducted to assess the adequacy and effectiveness of UN-Habitat's governance, risk management and control processes in providing reasonable assurance regarding **efficient and effective implementation of the UN-Habitat programme in Pakistan**.
8. OIOS included the assignment in the 2012 internal audit work plan following a request by UN-Habitat to review controls that were in place to mitigate financial and other operational risks.
9. The key controls tested for the audit were: (a) performance monitoring indicators and mechanisms; (b) regulatory framework; (c) delegation of authority system; and (d) security management systems. For the purpose of this audit, OIOS has defined these key controls as follows:

(a) **Performance monitoring indicators and mechanisms** - controls that provide reasonable assurance that metrics are: (i) established and appropriate to enable measurement of the efficiency and effectiveness of operations; (ii) prepared in compliance with rules and are properly reported on; and (iii) used to manage operations appropriately.

(b) **Regulatory framework** - controls that provide reasonable assurance that policies and procedures: (i) exist to guide the operations of the activity/programme in procurement and financial management; (ii) are implemented consistently; and (iii) ensure the reliability and integrity of financial and operational information.

(c) **Delegation of authority system** - controls that provide reasonable assurance that authority for certain functions has been delegated formally and in accordance with relevant regulations and rules.

(d) **Security management systems** – controls that provide reasonable assurance that security management systems are commensurate to the safety and security risks.

10. The key controls were assessed for the control objectives shown in Table 1.

11. OIOS conducted the audit from September to November 2012 at the UN-Habitat Headquarters in Nairobi, Kenya and UN-Habitat Office in Islamabad, Pakistan. The audit covered the period from January 2010 to July 2012.

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.

13. The audit mainly focused on three projects with a total budget of \$50.8 million or 88 per cent of projects that were being undertaken by UN-Habitat in Pakistan as at 31 July 2012. These projects were as follows:

(a) Project D307: the Rehabilitation of Community Infrastructure and Facilities in Khyber Pakhtunkwah for \$3.5 million funded by Donor 1;

(b) Project D315: the Pakistan Settlements Flood Recovery in Baluchistan, Khyber Pakhtunkwah, Punjab and Sindh for \$44.6 million funded by Donor 2 ; and

(c) Project D316: the Community Driven Shelter Interventions in Sindh for \$2.7 million that was funded by Donor 3.

14. The audit also, to a limited extent, reviewed 10 other projects with a total value of \$6.6 million that were in progress at the time of the audit.

III. AUDIT RESULTS

15. UN-Habitat governance, risk management and control processes examined were assessed as **partially satisfactory** in providing reasonable assurance regarding **efficient and effective implementation of the UN-Habitat Programme in Pakistan**. OIOS made eight recommendations to address issues identified in the audit. UN-Habitat was implementing projects in Pakistan despite a

challenging operational environment. Procurement activities were conducted transparently and competitively in accordance with the Procurement Manual. UN-Habitat implemented five out of the eight recommendations made by: strengthening controls to ensure development of specific and measurable performance indicators, obtaining donors’ formal approval for extension of projects beyond agreed completion dates, and complying with the United Nations Financial Rules that relate to expenditure. UN-Habitat was also implementing the remaining three recommendations relating to: development of guidelines for implementation of projects through community agreements; development of guidelines for identifying, addressing and reporting presumptive fraud; and review of security assessments.

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
Efficient and effective implementation of UN-Habitat programme in Pakistan	(a) Performance monitoring indicators and mechanisms	Satisfactory	Satisfactory	Satisfactory	Satisfactory
	(b) Regulatory framework	Partially satisfactory	Satisfactory	Satisfactory	Partially satisfactory
	(c) Delegation of authority system	Satisfactory	Satisfactory	Satisfactory	Satisfactory
	(d) Security management systems	Satisfactory	Satisfactory	Satisfactory	Partially satisfactory
FINAL OVERALL RATING: PARTIALLY SATISFACTORY					

A. Performance monitoring indicators and mechanisms

Need to ensure that project performance indicators are specific and measurable

16. All 13 projects reviewed had outlined performance indicators in the project documents but there was a need to refine the indicators. As shown in Table 2 below, some performance indicators used in three projects were not specific and measurable.

Table 2: Examples of inadequate performance indicators in project documents

Project number and name	Performance indicators	Comments
Project: D307 - Rehabilitation of Community Infrastructure and Facilities	1. Quantity of agricultural water increased;	Not specific and measurable.
	2. Quality and quantity of clean water increased;	Quantity and quality not specific and measurable.
	3. Roads access improved;	Improvements not measurable.
Project: D315 - Pakistan Settlements Flood Recovery	1. Security of tenure improved and land titles to be provided in name of husband and wife;	Expected improvements not specific and measurable.
	2. Twenty one districts with rehabilitated community infrastructure.	Nature of community infrastructures to be rehabilitated not specific. Not clear what rehabilitations to be conducted
Project: D316 - Community-driven shelter interventions in Sindh	1. Existence of functional accountability mechanism;	Functional accountability system not specific and measurable.
	2. Local host community information, participation and consultation;	Not specific and measurable.
	3. Integration of gender responsive and culturally sensitive approach;	Integration of gender responsiveness and culture sensitivity not specific and measurable.
	4. Quality, acceptability and appropriateness of shelter;	Quality, acceptability and appropriateness not specific and measurable.
	5. Use of participatory approach in design and placement of shelter.	Participatory approach in designing placement of shelters not specific and measurable.

17. Pakistan Office staff explained that in an emergency situation, with severe time constraints, it was not always feasible to have all the necessary data for defining specific performance indicators hence general indicators were initially developed and included in project documents. Thereafter, as more data was gathered during the implementation of projects, more specific indicators were developed. However, these were mainly for operational purposes and were not necessarily communicated back to the donors and used as benchmarks for the projects.

18. The lack of specific performance indicators in project documents could result in inability of UN-Habitat to measure and evaluate the success of the projects undertaken. It could also result in its inability to effectively report to donors successes achieved, loss of credibility and fund raising potential for other projects.

(1) UN-Habitat should ensure that project documents contain specific and measurable performance indicators to facilitate project performance evaluation and reporting.

UN-Habitat accepted recommendation 1 and stated that all four regional Project Review Committees and the Project Office are required to ensure more rigor and scrutiny in compliance with laid down project formulation standards which required specific and measurable indicators in project documents. Based on the action taken by UN-Habitat, recommendation 1 is closed.

Donors to approve project extensions

19. Two of the three projects reviewed in detail were not completed within the time estimated in the project documents due to justifiable reasons. These were Projects D315 and D316 which were delayed for over six months.

20. UN-Habitat communicated the need for project extensions to the donors before the expiry of the initial project end dates. In the case of Project D316, two amendments to the memorandum of understanding were signed between the UN-Habitat and Donor 3 on 29 February 2012 and 27 April 2012. As for Project D315, there was a memorandum, dated 16 January 2012, from the Director of ROAP to the Division of Management at UN-Habitat Headquarters requesting the extension from 31 January to 30 June 2012. The Country Programme Manager indicated that Donor 2 was informed about the extension, but there was no evidence of the donor's acceptance of the extension. It is important for UN-Habitat to obtain formal concurrence from donors on significant extensions of projects in order to maintain transparency in the project activities and to ensure continued donor support for future projects.

(2) UN-Habitat should ensure that project extensions are affected after obtaining formal acceptance from the donors that sponsor the affected projects.

UN-Habitat accepted recommendation 2 and stated that the Project Accrual and Accountability System has information that is used to manually alert project administrators to review projects that have exceptions. Furthermore, an automatic issue management and alert system is being developed. In addition, project revision guidelines require adequate documentation to support any revision including confirmation letter from donor. Based on the action taken by UN-Habitat, recommendation 2 is closed.

B. Regulatory framework

Personnel expenditure exceeded budgets

21. As at 30 September 2012, overall expenditure for the projects reviewed in detail were within approved budgets as indicated on Table 3.

Table 3: Overall budget performance for projects D307, D315 and D316 as at 30 September 2012

Project code	Project	Budget	2011	2012	Total expenditure	Balance
D307	Rehabilitation of Community Infrastructure and Facilities	\$3,460,000	\$2,539,386	\$874,959	\$3,414,345	\$45,655
D315	Pakistan Settlements Flood Recovery	44,629,670	34,509,297	8,511,679	43,020,975	1,608,695
D316	Community-driven Shelter Interventions in Sindh	2,688,335	2,498,579	12,181	2,510,760	177,575
		\$50,778,005	\$39,547,262	\$9,398,819	\$48,946,080	\$1,831,925

22. However, personnel expenditure for two projects (D307 and D315) exceeded budgets by \$4.6 million as shown in Table 4 below.

Table 4: Personnel expenditure for projects D307, D315 and D316 as at 30 September 2012

Project code	Project	Personnel budget	2011	2012	Total expenditure	Balance
D307	Rehabilitation of Community Infrastructure and Facilities	\$748,700	\$457,120	\$322,116	\$779,236	(\$30,536)
D315	Pakistan Settlements Flood Recovery	4,802,000	6,788,625	2,606,657	9,395,282	(4,593,282)
D316	Community-driven Shelter Interventions in Sindh	235,550	185,449	25,759	211,208	24,342
		\$5,786,250	\$7,431,194	\$2,954,532	\$10,385,726	(\$4,599,476)

23. UN-Habitat Pakistan Office management attributed the over expenditure on personnel in Project D315 to two factors. Firstly, as part of project implementation, UN-Habitat budgeted to use partners and allocated \$2.3 million for that purpose under budget code 2201. UN-Habitat did not appoint implementing partners and instead hired staff members to oversee the projects which were mainly implemented by the communities. Secondly, delays in completion of Project D315 resulted in additional personnel costs as staff members had to be retained for longer periods than originally envisaged. There was no evidence that the over-expenditure on personnel and the reallocation of funds from implementation by partners to personnel costs was duly approved by the Director of Regional and Technical Cooperation Division (RTCD), now Director of Project Office, or the donor that funded the project.

(3) UN-Habitat should ensure that expenditures are incurred in accordance with approved budgets and that any budget revisions are approved in accordance with the organization's policies and procedures.

UN-Habitat accepted recommendation 3 and provided documentation for budget revisions that were done for projects D307, D315 and D316. All the budget revisions were prepared and approved at the UN-Habitat Headquarters in December 2012. UN-Habitat had started using the newly developed the Project Accrual and Accountability System to monitor compliance with approved budgets in order to ensure non-recurrence of the issue. Based on the action taken by UN-Habitat, recommendation 3 is closed.

Need to base obligations on appropriate documentation

24. In February 2012, UN-Habitat recorded obligations of \$7.1 million in the expenditure accounts for the Pakistan Settlements Flood Recovery project (Project D315) as indicated in Table 5. Not all obligations were supported by formal contracts, purchase orders or other documents as required by Financial Rule 105.9. For example, 60 out of 610 community agreements (10 per cent) involving \$2.9 million, were signed between March and October 2012 after the obligation had already been recorded in February 2012. The obligations were based on projections of expenditure on various activities needed to complete the project.

Table 5: Obligations made in February 2012 relating to the Pakistan Settlements Flood Recovery project

Description	Amount
Community Agreements	\$4,768,700
Project personnel	923,817
Trainings and workshops	609,061
Equipment and premises	481,019
Miscellaneous	325,604
Total	\$7,108,201

(4) UN-Habitat should ensure all obligations are based on formal contracts, agreements, purchase orders or other form of undertakings or on liabilities as required by United Nations Financial Rule 105.9.

UN-Habitat accepted recommendation 4 and provided a copy of a memo to staff reminding them on the need to comply with Financial Regulation 105.9. Based on the action taken by UN-Habitat, recommendation 4 is closed.

Procurement rules were generally complied with

25. UN-Habitat Pakistan Office generally complied with Financial Regulations and Rules (FRR) and the Procurement Manual in purchasing goods and services. The solicitation and bidding processes were transparent and competitive and were well documented in 15 contracts/purchase orders involving \$1.3 million that were reviewed. Technical and commercial evaluations were conducted fairly and objectively, and contracts were awarded to lowest qualified bidders.

26. Payments were made to contractors and partners based on verified delivery of goods and services. All requests for payments were channeled through the Procurement Unit, which checked that the contractors had complied with the terms and conditions of contract.

Need for guidelines on use of community agreements

27. UN-Habitat had not developed guidelines and procedures for the use of the community agreements despite significant expenditures on the agreements especially during implementation of emergency projects. As at 7 October 2012, UN-Habitat had spent about \$26 million (60 per cent) on community activities in Project D315 under signed community agreements in which communities were expected to contribute up to \$19 million (40 per cent) in kind (labor and materials salvaged from disasters).

28. Community agreement guidelines and procedures would have assisted UN-Habitat management to ensure that adequate controls were developed to mitigate significant risks related to the use of the agreements. At the time of the audit, the Pakistan Office had already developed some procedures that could be used by UN-Habitat Headquarters as a starting point for the development of institutional guidelines and procedures.

(5) UN-Habitat should develop guidelines and procedures for implementing projects through community agreements.

UN-Habitat accepted recommendation 5. Recommendation 5 remains open pending receipt of a

copy of guidelines and procedures for implementation of projects through community agreements.

Need for procedures for reporting presumptive fraud

29. UN-Habitat Pakistan Office actively followed up with communities that did not comply with the terms and conditions of signed agreements. Out of 607 community agreements, 46 (7.6 per cent) were in default at the time of the audit and in some cases, the UN-Habitat Pakistan Office management had reasons to believe that the funds could have been misappropriated. In October 2012, UN-Habitat had paid a total of \$170,190 (or PKR 22.2 million) on community agreements mainly for construction of shelters and latrines, but the communities did not reach agreed milestones. UN-Habitat sought the assistance of the Pakistan Government Police Office to pursue the defaulters in order to recover the funds or ensure completion of the projects.

30. In another case, UN-Habitat suspected a local partner of overstating the cost of building materials in the construction of shelters. Under an agreement of cooperation, the local partner was assigned to construct 2,700 shelters at a cost of \$1.6 million. UN-Habitat Pakistan Office Management had reasons to believe and determined through an investigation that the cost of bitumen quoted in the payment requests was well above local market prices. The local partner disputed UN-Habitat's assertion and the matter had not been concluded at the time of the audit.

31. There was no evidence that guidelines were in place for identifying, addressing and reporting presumptive fraud to UN-Habitat Headquarters and thereafter to the Controller at United Nations Headquarters as well as to the Board of Auditors. Therefore, these matters were being resolved solely at UN-Habitat Pakistan Office.

(6) UN-Habitat should establish guidelines for identifying, addressing and reporting presumptive fraud from country/regional offices to the UN-Habitat Headquarters, Controller and the Board of Auditors.

UN-Habitat accepted recommendation 6. Recommendation 6 remains open pending receipt of confirmation that UN-Habitat has set up a mechanism for reporting presumptive fraud

Bank reconciliations prepared regularly

32. Monthly bank reconciliations were prepared and reviewed for the two bank accounts maintained with a local bank from January 2010 to July 2012. There were no long outstanding or unusual items in the reconciliations.

C. Delegation of authority

Guidelines for review mechanism for significant agreements with partners being finalized

33. There was a need for UN-Habitat to set up a review mechanism for significant cooperation agreements. In the case of ordinary contracts, amounts above \$150,000 were referred to UNON/LCC for review to ensure compliance with FRR and the Procurement Manual. However, in the case of agreements, the Acting Director of ROAP had delegation of authority to sign agreements up to \$1,000,000 as long as the agreements had been cleared by the UN-Habitat Legal Office. There was no requirement for legal clearance for agreements below \$300,000 unless there were changes to standard templates. The involvement of the Legal Office was intended to reduce legal and financial liabilities of UN-Habitat.

Other United Nations organizations had put in place a Partnership Committee at Headquarters, which reviewed all proposals for agreements above \$250,000 before they were signed by their Executive Director.

34. *UN-Habitat indicated that it would set up a formal partnership review mechanism for proposed agreements above a pre-determined threshold and stated that it was finalizing guidelines for a formal review and selection of implementing entities.*

35. UN-Habitat signed significant agreements with its partners. For example, on 24 March 2011, UN-Habitat signed an agreement of cooperation with Organization A for approximately \$1,000,000 for the construction of 1,700 shelters in Sindh Province (amended on 14 October, 2011, to include an additional 1,000 shelters and to increase the amount to \$1.6 million). Although UN-Habitat Pakistan Office complied with procurement procedures for solicitation, bidding process and evaluation, in the end, UN Habitat signed an agreement of cooperation (not a contract) with the partner. UN-Habitat Pakistan management explained that cooperation agreements were used with all not-for-profit organizations including Organization A, which was in that category. Lack of guidelines on when to use cooperation agreements could result in their use in place of procurement contracts. Therefore, procurement internal controls could be overridden which in turn, could result in not obtaining best value for money in the acquisition of goods and services.

(7) UN-Habitat should provide guidelines on acquisition of goods and services that could be done through cooperation agreements.

UN-Habitat accepted recommendation 7 and provided a copy of newly developed guidelines on acquisition of goods and services that could be done through corporation agreements. Based on the action taken by UN-Habitat, recommendation 7 is closed.

D. Security management systems

Need to involve UNDSS in security assessments

36. There had been no significant security incidents affecting UN-Habitat Pakistan staff and property since operations began in 2005 despite the high security risks in areas that UN-Habitat operated in. At the height of operations in 2011, UN-Habitat had the main office in Islamabad, 4 provincial offices and 12 field offices and at the time of the audit, there were two provincial offices and six field offices.

37. Not all reports of security assessments conducted were available at the time of the audit. Only 15 out of 22 (68 per cent) reports were on file. The UN-Habitat Security Officer, who conducted the assessments, indicated that all the offices had been assessed before occupation but some reports could have been misfiled.

38. There was no requirement for the United Nations Department of Safety and Security (UNDSS) to validate the assessments done by the UN-Habitat Pakistan Security Officer. Given the high security threats in areas that UN-Habitat operated, the security assessments conducted by UN-Habitat would have benefited from validation by UNDSS. This could have provided UN-Habitat management with additional assurance on the adequacy of security controls.

(8) UN-Habitat should request UNDSS validation of security assessments of office premises done by the UN-Habitat Pakistan Security Officer in order to provide additional assurance

to management given the high level of security risks in areas where UN-Habitat operated in Pakistan.

UN-Habitat accepted recommendation 8 and stated that it had developed a Manual of Standard Operating Procedures in 2011 which had a direct reference to the UN Policies and Procedures, regulations and rules and tailored to suit field operations. The Standard Operating Procedures have been disseminated and served as operational guide to all staff. The Standard Operating Procedures outlined a set of good practices and controls which enhance successful implementation of projects and programmes. Recommendation 8 remains open pending receipt of confirmation that UN-Habitat has requested UNDSS to validate security assessments conducted by UN-Habitat Pakistan Security Officer.

IV. ACKNOWLEDGEMENT

39. 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.



David Kanja, Assistant Secretary-General
Office of Internal Oversight Services

STATUS OF AUDIT RECOMMENDATIONS

Audit of UN-Habitat Pakistan Office

Recom. no.	Recommendation	Critical/ ¹ / important ²	C/ O ³	Actions needed to close recommendation	Implementation date ⁴
1	UN-Habitat should ensure that project documents contain specific and measurable performance indicators to facilitate project performance evaluation and reporting.	Important	C	Implemented	12 March 2013
2	UN-Habitat should ensure that project extensions are affected after obtaining formal acceptance from the donors that sponsor the affected projects.	Important	C	Implemented	12 March 2013
3	UN-Habitat should ensure that expenditures are incurred in accordance with approved budgets and that any budget revisions are approved in accordance with the organization's policies and procedures.	Important	C	Implemented	12 March 2013
4	UN-Habitat should ensure all obligations are based on formal contracts, agreements, purchase orders or other form of undertakings or on liabilities as required in the United Nations Financial Rule 105.9.	Important	C	Implemented	12 March 2013
5	UN-Habitat should develop guidelines and procedures for implementation of projects through community agreements.	Important	O	Receipt of a copy of guidelines and procedures for implementation of projects through community agreements.	31 July 2013
6	UN-Habitat should establish guidelines for identifying, addressing and reporting	Important	O	Receipt of confirmation that UN-Habitat has set up a mechanism for reporting	30 June 2013

1 Critical recommendations address significant and/or pervasive deficiency or weakness 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.

2 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.

3 C = closed, O = open

4 Date provided by UN-Habitat in response to recommendations.

Recom. no.	Recommendation	Critical/ important ²	C/ O ³	Actions needed to close recommendation	Implementation date ⁴
7	<p>presumptive fraud from country/regional offices to the UN-Habitat Headquarters, Controller and the Board of Auditors.</p> <p>UN-Habitat should provide guidelines on acquisition of goods and services that could be done through corporation agreements.</p>	Important	C	<p>presumptive fraud.</p> <p>Implemented</p>	12 March 2013
8	<p>UN-Habitat should require UNDSS validation of security assessments of office premises done by the UN-Habitat Pakistan Security Officer in order to provide additional assurance to management given the high level of security risks in areas where UN-Habitat operated in Pakistan.</p>	Important	O	<p>Receipt of confirmation that UN-Habitat has requested UNDSS to validate security assessments conducted by UN-Habitat Pakistan Security Officer</p>	30 April 2013