



Global Environment Facility

GEF/C.25/Inf.6
June 1, 2005

GEF Council
June 3-8, 2005

GEF TRUST FUND AUDIT ISSUES

(Prepared by Trustee)

GEF
Trust Fund Audit Issues
May 2005

INTRODUCTION

1. GEF Council members recently requested an update on the status of certain audit matters set out in the draft 2004 financial statements of the implementing agencies' accounts. The Trustee has prepared this note to update the Council members. The audit matters in the draft 2004 Annual Report that had been circulated to GEF Council members, the questions asked by GEF Council members, and the corresponding response and update follow.

AUDIT OPINION OF UNDP 2004 ACCOUNTS

2. **On audit opinion of UNDP:** "...I draw attention to the UNDP directives in respect of GEF nationally executed projects of \$71 million. Although we continue to note significant improvements, I am concerned about the adequacy of the assurance obtained by UNDP that funds have been properly used for the purposes intended."

a. **Council Member Comments:** "A similar note was on the audit opinion for the UNDP in the 2003 report." Council members requested an explanation and description of follow up actions on this matter.

b. **Response:** *UNDP has conveyed that, as stated in the audit opinion, UNDP does have a few cases where audits were not completed in time in spite of UNDP's continuous efforts to ensure full compliance. UNDP informs that in this connection their Office of Audits and Performance Review (OAPR) is in the process of improving monitoring of National Execution (NEX) audits and that full compliance is expected in the future.*

c. *For information, UNDP only audits projects with more than \$ 100,000 in expenditure during the year under review. UNDP has indicated that in CY03 projects under NEX incurred expenditures of \$71.2 million, of which \$66.3 million were included in the audit plan based on the aforementioned criterion. The audit compliance was close to 100% and the expenditure that was audited constituted 93% of the total GEF related expenditure under the NEX projects.*

NOTES TO GEF TRUST FUND FINANCIAL STATEMENT (FOR IBRD as IA) FOR FY04

3. **On Note 8 -- Disbursements with Repayment Provisions:** "As of June 30, 2004 and 2003, IFC, acting as executing agency for IBRD as IA, had disbursed grants with repayment provisions totaling \$22,576,028 and \$21,795,869 respectively to grant recipients. In accordance with the cash receipts and disbursements basis of accounting, IBRD as IA has not established any receivables due from grant recipients, nor has it recorded any payable to the GEF Trust Fund."

a. **Council Member Questions:** "Please explain why there have been no receivables established or any payable recorded to the GEF Trust Fund for these items. Do other Implementing Agencies have disbursements with repayment provisions? If they do, what are their receivables and payables recorded?"

b. **Response:** *An inter agency working group was established earlier this year by GEF Secretariat and Trustee on the development of policies and procedures regarding employment of non-grant instruments in GEF projects. For those grant disbursements with repayment provisions Trustee requires full reporting by the agencies to recognize, record and report these transactions and that all repayments be made to the GEF Trust Fund.*

c. *From a financial reporting perspective, the financial statements of IBRD as implementing agency are prepared on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under the cash receipts and disbursements basis of accounting, receipts are recorded when collected, rather than when pledged (or earned), and disbursements are recorded when paid, rather than when incurred. As such, IBRD as IA has not recorded any receivable or payable as at June 30, 2004 for grants with repayment provisions. In the event any repayments are received by IBRD as IA, they would be recorded by IBRD as IA in the period received. Any amounts returned by IBRD as IA to the Trustee would be recorded by IBRD as IA in the period in which such transfer took place.*

d. *UNDP and UNEP as implementing agencies have informed that they do not have any disbursements with repayment provisions.*

4. **On Note 9 – Disbursements:** "As noted in the FY 03 financial statements, the IBRD performs various compliance reviews of trust fund activity as part of its regular control framework. These reviews include GEF-financed activities for which IBRD acts as the Implementing Agency. During fiscal year 2002, IBRD as IA brought to the Trustee's and the CEO's attention that this work had identified certain matters which could result in ineligible expenditures in three recipient-executed grants. The CEO then brought this matter to the attention of the GEF Council in a letter dated April 21, 2003.

5. IBRD management is currently reviewing the findings of this work. Pursuant to paragraph 11 of Annex B of the Instrument of the Establishment of the Restructured GEF, the Trustee will work with IBRD and the CEO to address and resolve any concerns that may be raised by the findings and to determine the next steps. The CEO will keep the Council informed of the agreed steps as soon as this information is available."

a. **Council Member Questions:** "We very much appreciate that the strengthened compliance reviews helped identify these cases, and applaud the Bank's initiative. However, other than the letter of April 2003, I don't believe that the Council has been briefed on the situation. When will the Council be informed about the findings of this work? More generally, do these compliance reviews exist in the other accounts, e.g. UNDP and UNEP? If not, why not?"

b. **Response: Note 9 – Disbursements** now reads as follows: "Of the three recipient-executed grants, in one case, the recipient reimbursed the Trust Fund \$161,965 in June 2003, representing the full amount considered ineligible by the Bank's review, thereby closing this case. No irregularities were identified in the case of the second grant. The third grant is discussed further in Note 10."

c. **Note 10 – Subsequent Event** now reads: "With respect to the third grant identified in Note 9, IBRD management has reviewed the findings of this work. As a result of this review, in May 2005, IBRD has deemed it appropriate to reimburse \$2.42 million to the GEF Trust Fund."

d. As part of its own due diligence, Trustee requested an independent review by the Bank's Trust Fund Quality Assurance and Compliance Unit (TQC). TQC found the disposition for all three grants to be reasonable. Please see Attachment 1, prepared by IBRD as implementing agency, for a more detailed explanation of these three recipient executed grants.

e. On the question of whether compliance reviews exist for UNDP and UNEP. As indicated in Item 1 above, UNDP has conveyed that they conduct audits of projects with more than \$100,000 in expenditure. UNDP informs that in this connection their Office of Audits and Performance Review (OAPR) is in the process of improving monitoring of National Execution (NEX) audits and that full compliance is expected in the future. UNEP has conveyed that internal compliance reviews are undertaken on an annual basis by a team of independent external auditors appointed by the UN Board of Auditors, New York, in the context of the annual audit of UNEP's GEF Trust Funds that account for monies received from the GEF and for all UNEP/GEF project activities and expenditures. Their audit is conducted on a calendar year basis and covers the income, expenditures, assets, liabilities and fund balances. In addition, compliance reviews of UNEP are undertaken by the UN Office of Internal Oversight Services (OIOS) at their prerogative. UNEP require an independent external audit by a recognized firm of public accountants of all externally executed projects with GEF grants over \$100,000. As part of UNEP's own annual audit, their auditors place great emphasis on receipt of these third party audit certificates. For the past three years UNEP has fully complied with this requirement.

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: May 27, 2005

TO: Mr. Geoffrey Lamb, Vice President, CFPVP

FROM: Ian Johnson, Vice President, ESDVP



EXTENSION: 31053

SUBJECT: **Update on Recipient-Executed GEF Grants Referenced in the Audited Financial Statements**

I am attaching an update explaining the Bank's follow up on the recipient-executed GEF grants referenced in the Notes to the Statement of Cash Receipts, Disbursements and Fund Balance of the International Bank for Reconstruction and Development as an Implementing Agency of the Global Environment Facility. This note has been prepared under the direction of Jemal-ud-din Kassum and has been discussed within the Bank (LEG, MTO, OPCS, CTRVP and ENV).

Attachment

cc: Shengman Zhang (MDS); James Adams (OPCVP); Jemal-ud-din Kassum, Jeff Gutman (EAPVP); Marisa Fernandez-Palacios (EAPCO); Roberto Danino, Scott White, (LEGVP); Charles di Leva (LEGEN); Kyung-Hee Kim (MTO); John Underwood (OPCCS); Warren Evans, Steve Gorman, Rohit Khanna (ENV) Fayez Choudhury (CTRVP)

Update on Compliance Reviews for three recipient-executed GEF grants referenced in the Notes to the Statement of Cash Receipts, Disbursements and Fund Balance of the International Bank for Reconstruction and Development as an Implementing Agency of the Global Environment Facility

1. As noted in the FY03 financial statements of the World Bank as GEF Implementing Agency, the Bank performs various compliance reviews of trust fund activity, including those financed by the GEF, as part of its regular control framework. During FY 2002, the Bank brought to the GEF Trustee and CEO's attention that this work had identified certain matters which could result in ineligible expenditures in three recipient-executed GEF grants in two projects for which the Bank is the Implementing Agency. The CEO then brought this matter to the attention of the GEF Council in a letter dated April 21, 2003.

2. The purpose of this paper is to inform Trustee about the findings of the Bank's compliance reviews and follow-up actions taken by the Bank.

3. The first case refers to a project that was co-financed by two recipient-executed GEF grants totaling \$20 million. With respect to one grant for \$2.87 million, no allegations of irregularities were made and therefore no investigation was carried out, and the grant was closed at the end of project implementation. The other GEF grant for the project was for \$17.13 million. In 2002, following the detection of irregularities by Bank supervision missions in the use of the proceeds of the grant by the recipient, the Bank carried out an in-depth investigation. The investigation confirmed the alleged irregularities and further identified other deficiencies in the implementation of the grant activities by the recipient of the grant, an NGO that was also the implementing agency for the project. The deficiencies related to financial and procurement management practices. The amounts used for activities ineligible for grant financing could not be quantified due to the poor condition of the project's financial records and to the lack of access by the Bank's investigation team to project financial records.

4. The Government was apprised of the outcome of the Bank's investigation and has initiated criminal proceedings against some of the individuals responsible for the misuse of funds. Since the grant was made directly to the beneficiary NGO, the Bank has no direct legal rights to recover the funds from the Government. After seeking legal advice, the Bank decided that the costs of litigation or arbitration were likely to outweigh any monies that might be recovered from the project implementing agency in the event of successful litigation or arbitration. In any event, legal proceedings would likely be protracted with an uncertain outcome.

5. The Bank subsequently contracted an independent consultant to evaluate the Bank's supervision of the project, including the quality of the review of disbursement applications and ex-post procurement reviews. The consultant concluded that the Bank did not adequately carry out its supervision in respect of financial management. The consultant was unable to quantify the extent of ineligible expenditures for which grant funds had been disbursed. This would have required a complete external audit of the

grant recipient's accounts for the entire duration of the project, which is not feasible under the circumstances. However, based on detailed disbursement records and the NGO's audited statements, the consultant estimated the ineligible expenditures that the Bank might have been able to detect had it adequately carried out the supervision of the project as somewhere between \$1.8 million to \$2.42 million. Given the low prospects for recovering the misused funds from the recipient and the conclusions of the consultant review of the Bank's supervision of the grant, the Bank is reimbursing \$2.42 million to the GEF Trust Fund.

6. The Bank has cancelled the undisbursed balance of the grant of \$4.48 million, which has been returned to the GEF Trust Fund. In addition, an amount of about \$159,250 had been advanced to the beneficiary NGO under the special account provided under the grant. The Bank believes there is also a low prospect of recovering those funds from the NGO and is writing-off this amount.

7. The second case referred to in the notes to the financial statements of the World Bank as GEF Implementing Agency, is for a project with a GEF grant for \$15 million. Bank supervision missions found serious deficiencies in the grant recipient's financial control procedures with respect to the validation of payments to consultants. A detailed investigation by the Bank confirmed fraud, including forgery of documents, by a consultant firm to claim reimbursable expenditures under the grant. A total of \$161,965, the total considered as ineligible expenditures by the Bank's investigation, and an unutilized balance of \$346 remaining in the Special Account were refunded by the Government to the GEF Trust Fund. The undisbursed balance of the GEF Grant (approximately \$8 million) was cancelled and returned to the GEF Trust Fund, and the Grant was closed in December 2002. Following review by the Bank's Sanctions Committee, the consulting firm has been debarred for a period of five years.

8. Since the discovery of irregularities in the first case, Bank management increased the number and skills of fiduciary staff and tightened audit review and tracking practices in the concerned Bank office. Additionally, the Government has introduced an NGO certification program and only certified NGOs can now implement Bank-administered activities exceeding \$50,000. On a broader scale, the Bank has implemented a number of actions to improve its overall control framework around trust funds, including the establishment of the Trust Fund Quality Assurance and Compliance Unit, hard controls on trust fund transactions in the Bank's electronic transactions management system, mandatory training and accreditation for trust fund managers, real time transaction testing of trust fund disbursement transactions, and strengthened procurement policies requiring greater transparency.