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**OFFICE OF AUDIT AND INVESTIGATION SERVICES**

**AUDIT OF THE  
INVENTORY MANAGEMENT PROCESS**

**FINAL REPORT**  
N° FB-102

**25 June 2015**

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## EXECUTIVE SUMMARY

1. The Office of Audit and Investigation Services (OAIS) performed an audit of the UNFPA inventory management process activities conducted in the period from 1 January 2011 to 30 November 2014.

### Background

2. The supply to programme countries of reproductive health commodities, medical equipment and utensils, dignity and hygiene kits and other inventory items constitutes a significant component of UNFPA's programme, driven by UNFPA's strategic goal of achieving universal access to sexual and reproductive health, realizing reproductive rights and reducing maternal mortality, and by key initiatives such as UNFPA's Family Planning Strategy 2012-2020, "Choices, not Chance", and the Global Programme to Enhance Reproductive Health Commodity Security.

3. In the context of these initiatives, UNFPA supplied programme countries with inventory procured at a cost of approximately USD 650 million for the period from 1 January 2011 to 31 December 2013. In addition, UNFPA maintained inventory under its control, as reflected in UNFPA's statement of financial position, with a value of USD 46.5 million and USD 35.7 million as at 31 December 2013 and 2012, respectively.







### Methodology and scope

4. The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*, which require that internal auditors plan and perform the audit to obtain reasonable assurance on the adequacy and effectiveness of the governance, risk management and internal control processes in place. The audit included reviewing and analyzing, on a test basis, information that provided the basis for the audit conclusions.

5. The scope of the audit included the review of the inventory management process policies and procedures and governance arrangements, as well as the application of analytical review procedures on the information available in the procurement, order tracking and inventory management systems. The audit scope also included assessing controls in place and the level of compliance with inventory management policies and procedures and, for those areas not covered by such policies and procedures, the level of implementation of expected good practices. The audit covered 11 country offices visited in the period from 1 August 2013 to 30 November 2014, which supplied reproductive health commodities and other inventory items procured at a cost of approximately USD 97.0 million. In addition, the audit included the testing of a representative sample of inventory transactions managed by those offices amounting to approximately USD 32.0 million.

### Audit rating

6. The audit indicates that, for the period covered, the risk management performance of the inventory management process was '**Partially Satisfactory**', which means that governance, risk management and internal control processes were adequately established and functioning well, but one or more issues were identified, as discussed in the 'Detailed Findings' section of this report, that may negatively affect the achievement of the objectives of the process should they not be addressed by management. Ratings by key audit area are summarized in the following table.

<b>Audit ratings by key audit area</b>		
Process governance		Unsatisfactory
Order tracking and clearance		Partially satisfactory
Receiving and inspection		Partially satisfactory
Warehouse management and inventory control		Partially satisfactory
Delivery and distribution		Unsatisfactory
Inventory accounting and reporting		Satisfactory

*Key findings and recommendations*

7. The audit identified a number of good practices implemented by UNFPA, as well as areas that require management attention, some of a strategic nature and other related to operational and reporting matters. Overall, the audit report includes 21 high and medium priority recommendations designed to help UNFPA improve its inventory management process. Of the 21 recommendations, 3 are of strategic nature, 17 refer to operational matters and the remaining one is related to reporting.

*Good practices*

8. The issuance of the Inventory Management Policies and Procedures manual in November 2012 represented an important milestone by providing the framework for a more effective inventory management. From that point on, UNFPA has continued to take steps, primarily under the leadership of its Finance Branch, to enhance the capacity of Inventory Focal Points and other personnel involved in inventory management activities, as well as to enhance the systems used to track inventory flows and report inventory balances.

9. The audit also noted an effective management of the inventory held by the Procurement Services Branch, and the regular completion of commodity availability surveys for countries supported by the Global Programme to Enhance Reproductive health Commodity Security, which provide invaluable evidence that can be used by UNFPA country offices and implementing partners to enhance the effectiveness of their inventory management processes.

10. With regards to financial reporting, the audit noted that UNFPA implemented a process that allows it to report inventory balances in compliance with the requirements of the International Public Sector Accounting Standards.

*Strategic level*

11. At the strategic level, the audit pointed to the need to define the ultimate accountability for and ownership of the inventory management process, and to better define the roles and responsibilities of the different business units and managerial roles involved in the process. The audit also identified the need to expand the scope of the inventory management policies and procedures, in order to provide guidelines that would contribute to a more effective execution of operational inventory management and control activities.

*Operational level*

12. Activities assigned to Inventory Focal Points should be more clearly defined and a mandatory training programme developed to provide them with the skills required for a more effective performance of their duties.

13. The order tracking, receiving and inspection processes, as well as inventory controls, need to be enhanced. Managerial oversight controls have to be implemented at country office, regional office and headquarters level to ensure that: (i) inventory is timely cleared from customs and delivered to implementing partners and beneficiaries; and (ii) excess inventory is timely identified and distributed well ahead of its expiration date. In particular, regional office oversight over inventory management activities should be clarified and expanded.

14. Of paramount importance is the need to significantly increase and enhance monitoring of the distribution of inventory by implementing partners, to ensure that inventory promptly reaches its intended beneficiaries and to help discharge fiduciary accountability obligations towards the donors that fund the procurement of such inventory.

15. From a technology point of view, Management needs to ensure the timely implementation of the new order tracking and inventory control systems, currently planned to take place in 2015, which will provide the enhanced functionality required to help address several of the issues identified through this audit.

16. Finally, the audit observed the need to consistently document the delivery of inventory to implementing partners and beneficiaries, through the use of the handover and earmarking forms as prescribed by the policies and procedures in place.

*Reporting level*

17. Managements should also take prompt action to enhance the inventory accounting process, by recording inventory transactions through the use of general ledger control accounts and expensing inventory only at the time it is delivered to the implementing partners or beneficiaries for which it was procured.

Management response

18. Management has reviewed the OAI report on audit of the inventory management process and noted issues and control weaknesses identified in this report. UNFPA management acknowledges that the combination of factors such as the importance of reproductive health commodities to the organization's mandate, total amount spent on commodities every year, continuous growth trend and identified control weaknesses, all make inventory management an area that could be affected by risks of inefficient use of resources, waste and inability to meet program goals and objectives. Management further realizes that addressing these risks will require a series of actions by multiple parties within organization implemented over a period of time.

19. In Management's view, issues pertaining to the inventory management process can be grouped under the following categories:

- a) Strategic: accountability issues and allocation of roles and responsibilities within the business process;
- b) Operational: roles and responsibilities of Inventory Focal Points, 'in country logistics' management, capacity building within field offices, and inventory management information systems;
- c) Compliance: adherence to mandatory procedures and compliance requirements as per the UNFPA Inventory Management Policies and Procedures manual; and
- d) Reporting: visibility of inventory balances throughout current strategic information systems and data quality dashboards.

20. Management believes that no single unit within the organization will be able to address all issues associated with the inventory management process. Instead, concentrated efforts will be required from multiple parties. Therefore, Management will form an interdivisional working group led by the Commodity Security Branch, under the guidance of the Director of Technical Division. The working group will include representatives of the Finance Branch, Commodity Security Branch, Procurement Services Branch, Regional Offices and other parties. The working group will provide regular updates to the Deputy Executive Director, Programme, given direct linkages of inventory management and programme implementation, and to the Audit Monitoring Committee chaired by the Deputy Executive Director, Management. Management will task this interdivisional group with the responsibility for developing a comprehensive working plan by the end of September 2015, which will outline detailed steps for addressing all issues identified in the OAIS report, assign responsibility for implementing these steps and establish deadlines and key milestones. Determination of ownership and subsequent responsibilities will be assigned to business units that have the subject matter expertise and are strategically best positioned within organization to deal with particular issues. The action plan will employ a holistic approach to inventory management as a business process and will aim to fully integrate it within ongoing initiatives on 'supply chain', both 'upstream' and 'downstream'. This will be accompanied by a revision of the policy on Inventory Management Policies and Procedures by designated persons, and an update of the internal control framework for inventory.

21. Moreover, Management has already implemented a number of steps to improve management of reproductive health commodities in the organization. Some of these initiatives include:

- a) Development of a new system for recording, tracking and reporting on commodities, called Shipment Tracker System. This system represents an important step towards a more integrated supply chain information system, allowing users to have a single point of entry for recording, tracking and reporting on commodities. The Shipment Tracker System is fully integrated within the Atlas Enterprise Resource Planning system, and will provide live data on volumes of commodities procured, held and distributed by the organization at any point in time. The Shipment Tracker System will also ensure business process 'continuum' and minimize any delays in the processing of transactions;
- b) Along the Shipment Tracker System release, Inventory Focal Points will receive an extensive user guidance and training that will enable them to effectively and successfully operate the new system;

- c) After the new system implementation, UNFPA will be able to generate diagnostic reports for Management on the status of in-transit and warehoused commodities and to escalate to the attention of Management situations where metrics indicate protracted criticalities, such as long delivery times, inventory losses and bottlenecks within the in-country logistic chains. UNFPA aims to build reports upon standard metrics (number of days between financial and physical receipt dates; number of days between financial receipt and hand-over to implementing partners, etc.) therefore proactively identifying red flags;
- d) The new system will enable better accounting records and budget management practices for inventory. At minimum, inventory balances would be posted into the general ledger on a monthly basis, instead of on a quarterly basis, as is the case at the moment. Moreover, Management currently examines 'budgetary incentives' to penalize field offices holding inventories for long periods of time – these incentives will be applied to Regular Resources and the Global Programme to Enhance Reproductive Health Commodity Security purchases, and will mirror the Operating Fund Account mechanism, which obliges field offices to fund outstanding asset balances not yet liquidated with fresh financial allocations in future years;
- e) Management has started consultations with Regional Offices on their role in providing monitoring, oversight and support over reproductive health commodities management. As a result of a meeting held on 4 June, it was agreed that each Regional Office will nominate a focal point within its office who will work closely with both headquarters units and field offices on issues related to inventory management. It was also agreed that Regional Offices will review justifications of all offices currently holding inventory and will clear all requests to be submitted in the future. Clearance will only be granted to offices with demonstrated capacity to handle inventory;
- f) Management will explore options for further collaboration with other United Nations organizations, such as the World Food Programme, that have recognized expertise in stock management. Such collaboration will encourage transfer of stock management responsibilities from UNFPA to the agencies that have much greater expertise and comparative advantage in this area than UNFPA does; and
- g) The Procurement Services Branch will continue to support country offices in establishing long-term agreements with freight forwarding companies, jointly with the other UN organisations in countries. Field offices will then be able to use the services of these companies for custom clearance processes, thus decreasing turn-around time between shipment of commodities and their receipt by final beneficiaries.

22. The remaining issues raised in the OAIS report will be addressed through a collective response outlined in the detailed plan, follow up discussions with Regional Directors and main stakeholders, and the release of the Shipment Tracker System.

23. The OAIS team would like to thank the Management and personnel of the Commodity Security, Finance, Management Information Services and Procurement Services Branches, as well as of the different country offices covered by the audit as regards their inventory management activities, for their cooperation and assistance throughout the audit.

## I. OBJECTIVES, SCOPE AND METHODOLOGY

1. The audit covered inventory management process activities conducted in the period from 1 January 2011 to 30 November 2014.
2. The objective of the audit, conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*, was to provide reasonable assurance about the effectiveness of the governance, risk management and internal control over UNFPA's inventory management process.
3. The audit included such tests, as considered appropriate, to obtain reasonable assurance with regards to:
  - a) The effectiveness and efficiency of inventory management activities;
  - b) The level of compliance with applicable regulations, rules, policies and procedures;
  - c) The safeguarding of inventory against loss or misappropriation along the different components of the supply-chain; and
  - d) The accounting, valuation and reporting of inventory in compliance with the requirements of the International Public Sector Accounting Standards.
4. The scope of the audit included the review of the inventory management process policies and procedures and governance arrangements, as well as the application of analytical review procedures on the information available in the procurement, order tracking and inventory management systems. The audit also included assessing controls in place and the level of compliance with inventory management policies and procedures and, for those areas not covered by such policies and procedures, the level of implementation of expected good practices. The audit covered 11 country offices visited in the period from 1 August 2013 to 30 November 2014 which supplied reproductive health commodities and other inventory items procured at a cost of USD 97.0 million. In addition, the audit included the testing of a representative sample of inventory transactions conducted by those countries amounting to USD 32.0 million.
5. The engagement was conducted by a team of OAIS audit specialists in three different phases. During the first phase, conducted between August and October 2012, the audit team performed analytical review procedures and site visits to three country offices and the Procurement Services Branch, to observe and test inventory management activities and develop a baseline for the assessment of the inventory management policies and procedures that were under development at the time. During the second phase, between November and December 2012, the audit team provided feedback to management on the content of the proposed inventory management policies and formulated several recommendations to enhance them. During the third phase, conducted throughout 2013 and 2014, OAIS tested inventory management activities and the level of compliance with the requirements of the Inventory Management Policies and Procedures at the 11 country offices visited in that period.
6. The findings and recommendations resulting from the audit were discussed with the Finance Branch management at an exit meeting held on 12 December 2014. Comments and clarifications provided were reflected in a draft report submitted to Management on 19 December 2014. A final Management response, received on 22 June 2015, is reflected in the report.



## II. BACKGROUND

7. The supply to programme countries of reproductive health commodities, including hormonal contraceptives, male and female condoms and reproductive health kits, as well as other inventory items, such as pharmaceutical products, medical equipment and utensils, and dignity and hygiene kits, constitutes a significant component of UNFPA’s programme driven by UNFPA’s strategic goal of achieving universal access to sexual and reproductive health, realizing reproductive rights and reducing maternal mortality. It is also driven by key initiatives such as UNFPA’s Family Planning Strategy 2012-2020, “Choices, not Chance”, and the Global Programme to Enhance Reproductive Health Commodity Security (GPRHCS), launched in 2007 and which entered a new phase in 2013, scaling up its intervention to 46 priority countries.

8. Achievement of the above goals is also enabled through the provision of third-party procurement services, which enhance access by governments, non-governmental organizations and development partners to quality-assured contraceptives and other reproductive health commodities leveraging on the long-term agreements established by UNFPA with leading manufacturers and distributors.

9. Table 1 below presents an overview of the value of inventory supplied between 2009 and 2013, broken down by major categories:

**Table 1 – Analysis of inventory supplied**  
Millions of United States Dollars

Inventory categories	2013	2012	2011	2010	2009
Contraceptives	152.6	127.9	87.8	84.9	80.7
▪ <i>Hormonal contraceptives</i>	108.4	95.6	51.5	55.9	57.8
▪ <i>Condoms</i>	40.9	29.7	32.9	25.5	20.3
▪ <i>Other<sup>1</sup></i>	3.3	2.6	3.4	3.5	2.6
Medical equipment and supplies <sup>2</sup>	30.5	25.9	24.1	29.6	21.1
Pharmaceutical products	7.3	6.9	3.7	6.0	8.2
<b>Total</b>	<b>190.4</b>	<b>160.6</b>	<b>115.6</b>	<b>120.5</b>	<b>110.0</b>

Source: UNFPA annual procurement statistics

10. The increase in the supply of contraceptives and other inventory items to meet programme needs has in turn resulted in the recognition of significant inventory balances at UNFPA’s financial statements, in conformity with the requirements of the International Public Sector Accounting Standards (IPSAS), implemented by UNFPA in 2012. Under IPSAS, inventory is reflected as an asset in UNFPA’s Statement of Financial Position up to the moment when control over the inventory is transferred to implementing partners or other programme beneficiaries, or to a third-party procurement services client. The amount reflected in the UNFPA Statement of Financial Position therefore represents both inventory shipments in-transit to their destination place or stationed at the port of entry and not yet physically handed over to implementing partners or beneficiaries, as well as inventory stored in warehouses under the control of the Procurement Services Branch (PSB) or country offices. Inventory

<sup>1</sup> Includes the cost of art-work, packaging and condom testing.

<sup>2</sup> Includes reproductive health, dignity and hygiene kits.

balances also include items of property, plant and equipment on route to implementing partners and under UNFPA control. These items are expensed upon transfer.

11. Table 2 below presents an analysis of inventory balances reported as of 31 December 2013 and 2012 and 1 January 2012 (date of the initial adoption of IPSAS by UNFPA).

**Table 2 – Analysis of inventory balances**  
Millions of United States Dollars

Inventory categories	31 December		1 January
	2013	2012	2012 <sup>3</sup>
Reproductive health commodities	42.5	32.7	13,9
▪ In transit to their destination	29.2	26.3	5.7
▪ In stock <sup>4</sup>	13.3	6.4	8.2
Property, plant and equipment-like inventory in transit	4.1	3.0	1.9
<b>Total</b>	<b>46.6</b>	<b>35.7</b>	<b>15.8</b>

Source: UNFPA audited financial statements

12. Inventory management activities are guided by the Inventory Management Policies and Procedures manual released in November 2012, as part of the process undertaken by UNFPA to revise its core business processes in response to the requirements of IPSAS. The preparation and issuance of the manual was led by UNFPA’s Finance Branch, in collaboration with staff from PSB and the Commodity Security Branch (CSB).

13. The Inventory Management Policies and Procedures manual outlines six key principles that should guide inventory management activities at UNFPA:

1. Ensure timely delivery of goods to implementing partners and beneficiaries on the ground;
2. Ensure integrity and accuracy in financial and administrative recording of inventory;
3. Promote consistency and accuracy in the valuation and reporting of UNFPA inventory;
4. Promote compliance with relevant CSB, PSB and financial guidelines;
5. Ensure UNFPA inventory is properly safeguarded, sorted and managed, to avoid spoilage, waste and theft; and
6. Safeguard the best interest of final beneficiaries in the distribution of UNFPA inventory.

14. The manual focuses on down-stream supply-chain management activities and details the policies and procedures applicable in the areas of: (i) inventory record-keeping and maintenance of inventory data; (ii) inventory valuation and financial disclosure; (iii) inventory safeguarding and control; (iv) inventory storage; (v) inventory loss and theft; and (vi) verification and certification. By design, the policy does not cover up-stream supply-chain management activities, such as commodity needs assessment and forecasting.

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<sup>3</sup> Initial recognition of IPSAS inventory balances.

<sup>4</sup> Includes inventory under PSB control, which consists primarily of reproductive health kits and male and female condoms held at vendor premises with the purpose of expediting their delivery to satisfy UNFPA programme commodity needs and/or third-party procurement orders.

15. Inventory management activities are the responsibility of Inventory Focal Points appointed by the Chief, PSB and by the heads of country offices to which inventory is supplied. PSB's inventory management activities are supported by the Atlas inventory management module, while country offices track and report inventory through the use of CHANNEL, a web-based application initially developed by UNFPA to support implementing partners with their own commodity management activities and which was subsequently adapted to suit the needs of UNFPA's inventory management.

16. Inventory accounting and reporting is the responsibility of UNFPA's Finance Branch, part of the Division for Management Services, in collaboration with PSB and country office programme and finance staff involved in inventory management activities.

### III. DETAILED FINDINGS

#### A. PROCESS GOVERNANCE

**UNSATISFACTORY**

##### *Work performed*

17. In addition to observation and testing of inventory management activities conducted at PSB and the different country offices visited in the course of the audit, work performed in this area included: (i) a review of the guidelines and document templates contained in the Inventory Management Policies and Procedures manual and the Procurement procedures; (ii) interviews with key Finance Branch, CSB and PSB personnel; (iii) inquiries and observation of the activities performed by designated Inventory Focal Points and other personnel involved in inventory management activities at the country offices visited in the course of the audit; (iv) a walk-through of the systems used to support inventory management activities; (v) the review of materials used for training inventory focal points and other personnel involved in inventory management activities; and (vi) interviews with donor representatives in the countries visited by the audit to inquire about their views on programme activities involving the supply of reproductive health commodities.

##### *Good practices identified*

18. The issuance of the Inventory Management Policies and Procedures manual in November 2012 represented an important milestone by providing the framework for a more effective management of inventory, a process that was previously loosely governed by a multiplicity of policy documents and administrative instruments and was primarily based on varying practices established by the country offices managing inventory.

19. Since the release of the manual in 2012, UNFPA has continued to take steps, primarily under the leadership of the Finance Branch, to enhance the capacity of Inventory Focal Points and other personnel involved in inventory management activities, as well as to enhance the systems used to track inventory flows and report inventory balances.

##### *Improvement areas identified*

20. Based on the audit work performed, the audit noted the following matters that require management attention.

##### *Define more clearly the ultimate accountability for the inventory management process as well as the roles and responsibilities of actors involved in the process*

21. The ultimate accountability for effectively and efficiently operating the inventory management process and achieving the key principles guiding inventory management activities (see paragraph 13 of the Background section) is not clearly defined in the Inventory Management Policies and Procedures manual or in other governance guidelines.

22. The manual assigns responsibility for components of the process to different business units and management roles.<sup>5</sup> Responsibility for inventory management activities is assigned to Regional Directors and Heads of Office, as well as to the Chiefs, CSB and PSB. The Chief, CSB is in turn responsible for overseeing and supporting inventory management at country office level, while the Chief, PSB is responsible for managing the inventory under the control of PSB. Per the manual, the Finance Branch

<sup>5</sup> Section A.7 of the Inventory Management policies and procedures manual.

responsibility is limited to supporting the inventory valuation process and the all aspects related to reporting inventory in the financial statements of UNFPA.

23. The audit noted that, in practice, Regional Offices are neither involved in a meaningful nor in a consistent manner, in the management or oversight of the inventory process. The manual is also silent on the extent of involvement expected from them.

24. While the manual names both the Chiefs, CSB and PSB as responsible for inventory management, those responsibilities assigned to PSB are limited to ensuring that expected and actual delivery dates are reflected in the Order Tracking System. The manual is also silent on who has responsibility for overseeing inventory management activities performed by PSB. CSB responsibilities are further elaborated in the manual and refer primarily to inventory transactions tracking, including: (i) support to and oversight of the correct tracking and reporting of inventory data by country offices; (ii) monitoring of the use of earmarking and receipt forms; and (iii) guidance on and administration of the use of CHANNEL by country offices. The latter responsibilities are inextricably linked to inventory accounting and reporting and have been gradually assumed by the Finance Branch, which has become the *de-facto* owner of the inventory management process. The manual does not clearly define the nature and extent of the activities to be undertaken by CSB either, including those by the regional commodity security advisors funded from the GPRHCS, to support key operational inventory management activities, such as security and control of inventory, inventory storage, warehouse management and distribution.

25. Finally, a significant gap in the manual is that it does not define the responsibilities of programme personnel responsible for the programme outputs driving the procurement and supply of inventory.

26. The nature and recurrence of issues identified by the audit (refer to sections B to D of this report) seem to indicate that, mainly as a consequence of the above mentioned gaps, support provided to country offices during the period under review was insufficient to enhance the effectiveness of inventory management activities -especially those of operational nature- and that process oversight was insufficient, except as required for annual financial reporting purposes.

IMPACT	<i>The effectiveness of the inventory management process may be diminished due to insufficient support to and oversight over the process.</i>
ROOT CAUSE	<i>Guidelines (inadequate corporate policies and procedures).</i>
CATEGORY	<i>Strategic.</i>

<b>RECOMMENDATION 1</b>	<b>PRIORITY: HIGH</b>
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*Modify the Inventory Management Policies and Procedures manual to (i) formalize the Finance Branch ownership of the Inventory Management process, as defined by the scope of the policy and (ii) redefine, as necessary, the roles and responsibilities of the other business units and managerial roles involved in the inventory management process.*

<u>RESPONSIBLE MANAGER:</u> <i>Deputy Executive Directors, Management and Programme</i>	<u>STATUS:</u> <i>Agree</i>
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<u>MANAGEMENT ACTION PLAN:</u> <i>Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.</i>	<u>DUE DATE:</u> <i>To be determined</i>
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**RECOMMENDATION 2**

**PRIORITY: HIGH**

*Allocate adequate resources to the Finance Branch to allow for an effective support to and oversight over the inventory management process.*

RESPONSIBLE MANAGER: *Deputy Executive Director, Management*      STATUS: *Agree*

MANAGEMENT ACTION PLAN:      DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

*Promptly release the planned update to the Inventory Management Policies and Procedures manual and extend its scope to cover additional operational areas*

27. The audit noted that the Inventory Management Policies and Procedures manual provides a clear definition of inventory, compliant with IPSAS requirements, and specifies the requirement for Headquarters authorization prior to holding inventory at warehouses under the control of UNFPA; the general rules for control, recognition and earmarking of inventory; and the responsibilities and authorities for inventory management activities.

28. Overall, the manual provides adequate guidelines for core inventory management and accounting activities performed by UNFPA from the point at which the Organization receives legal title to the goods<sup>6</sup> to the point in which the goods are handed-over to implementing partners, programme beneficiaries or third-party procurement services clients. These guidelines relate primarily to the procedures applicable in the areas of: (i) inventory record-keeping and maintenance of inventory data; (ii) inventory valuation and financial disclosure; (iii) inventory security and control; (iv) inventory storage; (v) inventory loss and theft; and (vi) verification and certification. Overall, the policy guidelines provide an adequate basis for the achievement of inventory management principles 2 to 5<sup>7</sup> (mentioned in paragraph 12 of the Background section).

29. The audit noted, however, several areas where guidelines could be enhanced to make the manual the prime reference guide for Inventory Focal Points and other personnel involved in inventory management activities, in particular related to: (i) operational tracking of inventory along the different supply-chain steps; (ii) receiving and inspection controls; and (iii) customs clearance activities. Limited guidelines on these three activities are provided in the Procurement procedures; the latter lack the level of detail required to support a more effective process, as evidenced by the issues identified in these areas (further elaborated in sections B and C). The policy also provides limited guidance on inventory operational reporting and monitoring.

30. In addition, the audit noted that the manual provides extremely limited guidance on the processes and controls related to inventory delivery and distribution required for the achievement of inventory management principles 1 (ensure timely delivery of goods to implementing partners and beneficiaries on the ground) and 6 (safeguard the best interest of final beneficiaries in the distribution of UNFPA inventory). The OASIS team was not able to identify other policies and procedures that could guide country offices in their activities related to inventory delivery and distribution, areas in which the audit noted pervasive issues of a recurring nature (further detailed in section E).

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<sup>6</sup> Normally through a bill of lading or other official shipping document, for internationally procured goods, or upon receipt of the goods, for locally procured goods.

<sup>7</sup> See paragraph 13 - Background section.

31. The audit also noticed opportunities to simplify the structure of the manual, for example, by merging the guidelines included in sections D (Security and Control of Inventory), E (Inventory Storage) and F (Inventory Losses), which are either related or partially redundant.

32. The Finance Branch indicated that an update of the Inventory Management Policies and Procedures manual will take place in 2015, and will reflect the changes in the inventory management process since the issuance of the manual in 2012.

IMPACT	<i>The effectiveness of the inventory management process may be diminished due to a lack of clear operational guidelines.</i>
ROOT CAUSE	<i>Guidelines (inadequate corporate policies and procedures).</i>
CATEGORY	<i>Strategic.</i>

<b>RECOMMENDATION 3</b>	<b>PRIORITY: HIGH</b>
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*Promptly complete the planned update to the Inventory Management Policies and Procedures manual, streamlining its content and extending its scope to cover all key downstream process activities, including: (i) tracking of inventory along the supply-chain steps; (ii) receiving and inspection controls; (iii) customs clearance activities; (iv) operational reporting and monitoring; (v) delivery; and (vi) distribution to beneficiaries.*

RESPONSIBLE MANAGER: *Deputy Executive Director, Management*      STATUS: *Agree*

MANAGEMENT ACTION PLAN:      DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

*Further clarify the activities assigned to Inventory Focal Points and develop standard operating procedures, tools and a training programme to support their functions*

33. As explained earlier (paragraph 15 of the Background section), most inventory management activities, other than the physical custody of goods, are delegated of Inventory Focal Points.

34. The Inventory Management Policies and Procedures manual provides a reasonably clear definition of the Inventory Focal Point main responsibilities, detailed guidelines for some of the activities the Focal Points perform (such as physical inventories), and templates for the most common activities, such as Earmarked Goods Custody and Inventory Receipt forms (used to document the transfer of goods to implementing partners).

35. The audit noticed, however, that the manual provides limited operational guidelines and tools in some areas of Inventory Focal Point responsibility, most notably those related to order tracking, custom clearance, receiving and inspection and inventory issuance. The audit also noted that the level of detail provided in the inventory management component of the Internal Control Framework is, overall, insufficient. The framework details only some internal control activities to be undertaken by Inventory Focal Points and does not include a detailed description of the procedures to be applied for many of the control activities. In addition, the audit noted that there is no standard job description for the Inventory Focal Point role.

36. The nature and recurrence of issues identified by the audit (further elaborated in sections B to D later) suggest that, during the period under review, Inventory Focal Points and other personnel involved in inventory management activities in some country offices did not discharge their assigned duties effectively, due to a combination of factors, including the above mentioned gaps in the manual and in the internal control framework, a partial understanding of the requirements of the manual, insufficient

skills or experience in the area of inventory management, and or lack of alignment between the demands of the role and the amount of time devoted to it.

37. From the time of issuance of the Inventory Management Policies and Procedures manual through October 2014, the Finance Branch presented six inventory management webinars, with strong focus on the use of the inventory management system and on inventory accounting and reporting activities. The Finance Branch indicated that it has been challenging to ensure full and regular participation by Inventory Focal Points in some country offices. As an example, only 20 per cent of Inventory Focal Points participated in a webinar presented in June 2014, while approximately 14 per cent of them participated in the webinar presented in October 2014. Most notably, there was no participation at either webinar by staff from certain country offices where the audit identified inventory management issues requiring prompt management attention.

IMPACT	<i>The effectiveness of the inventory management process may be diminished due to the lack guidelines, tools and skills.</i>
	<i>Guidelines (Lack of written procedures to guide staff in performing their functions).</i>
ROOT CAUSE	<i>Resources (Insufficient human resources).</i>
	<i>Resources (inadequate training).</i>
CATEGORY	<i>Operational.</i>

**RECOMMENDATION 4**

**PRIORITY: HIGH**

*Expand and enhance the level of operational guidance provided in the Inventory Management Policies and Procedures manual and in the inventory management component of the Internal Control Framework.*

RESPONSIBLE MANAGER: *Chief, Finance Branch*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**RECOMMENDATION 5**

**PRIORITY: HIGH**

*With support from the Division for Human Resources and the Technical Division, develop a standard job description for the Inventory Focal Point role, clearly specifying the activities they undertake and the skills and experience required for fulfilling the role.*

RESPONSIBLE MANAGER: *Chief, Finance Branch*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**RECOMMENDATION 6**

**PRIORITY: HIGH**

*With support from the Division for Human Resources and the Programme and Technical Divisions, design and implement a mandatory inventory management certification training course, covering all activities within the scope of the inventory management process, with appropriate emphasis on operational activities and controls. Enforce certification requirements by limiting access to the inventory management system to certified personnel only.*



RESPONSIBLE MANAGER: Chief, Finance Branch

STATUS: Agree

MANAGEMENT ACTION PLAN:

DUE DATE: To be determined

Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.

**B. ORDER TRACKING AND CLEARANCE**

**PARTIALLY SATISFACTORY**

*Work performed*

38. Audit work performed in this area included: (i) a walk-through of the 'Order Tracking System' (OTS) functionality and of the controls in place to ensure the system reflects accurate and complete information; (ii) walk-throughs of the processes followed for order tracking and clearance at the country offices visited in the course of the audit; and (iii) the review of order tracking and clearance for the sample of inventory transactions selected for testing at the country offices visited in the course of the audit.

*Improvement areas identified*

39. Based on the audit work performed, the audit noted the following matters that require management attention.

Improve the effectiveness of the order tracking process and systems

40. Most inventory orders are placed by PSB, based on requisitions created by CSB or by country offices. Orders can be sourced either from new production or from stocks previously procured by PSB and maintained at manufacturers' facilities, with the objective of reducing supply lead times.

41. The status of PSB inventory orders is monitored through OTS, a web-based order tracking system developed by UNFPA, with limited integration with Atlas. Orders are uploaded from the Atlas procurement module in OTS through an automated interface. PSB is responsible for ensuring that suppliers and/or freight forwarders update the system with orders' actual delivery (i.e., shipping), and actual and estimated arrival dates. Tracking orders from the point products are shipped is the responsibility of country offices, so is updating dates for other process milestones tracked, such as the physical receipt date.

42. The effectiveness of order tracking is affected by limitations in OTS functionality. OTS does not allow tracking at order line-item level, limiting the tool usefulness when orders are delivered through multiple shipments. The tool does not track milestones beyond the arrival of goods at the port of destination, for example the dates of custom clearance, transfer to UNFPA controlled warehouses and hand-over of goods to implementing partners. In addition, the system is not used to track inventory procured directly by country offices.

43. The audit noticed issues regarding OTS data integrity, completeness and accuracy. For example, a large number of orders issued in 2011 selected for review did not reflect the estimated and/or actual delivery and/or arrival dates. However, OTS data completeness improved significantly following the introduction of the requirement for suppliers to update OTS with the estimated delivery and arrival dates as a condition for receiving payment. Dates of physical receipt of goods were not updated by country offices for 87 per cent of the orders issued in 2012. Data completeness issues were also noted in the course of several country office audits performed in 2013 and 2014.

44. During the period under review, some country offices used alternative tracking systems, typically based on the use of locally developed spreadsheets or databases. These efforts are commendable in as they provide management with the capability to better track orders; however, they also result in data duplication, create the risk of relying on inaccurate or incomplete information for decision-making purposes and increased staff workload which may not be sustainable over time. In addition, the audit noted that frequently, country offices do not timely update these alternative tracking tools, further limiting country office management ability to manage inventory in a more effective manner and resolve issues along the supply-chain.

45. Management indicated that order tracking will be enhanced following the implementation in 2015 of a new Order Management System, which will include an order tracking module that will replace OTS.

IMPACT *The inability to track orders may result in increased lead times and reduce availability of key reproductive health commodities.*

ROOT CAUSE *Resources (inadequate corporate systems).  
Guidance (Inadequate supervision at county office level).*

CATEGORY *Operational.*

**RECOMMENDATION 7**

**PRIORITY: MEDIUM**

*Promptly release the new Order Management System, which includes functionality designed to substitute the Order Tracking System, and, in conjunction with the Finance Branch, provide training to Inventory Focal Points to improve inventory order tracking.*

RESPONSIBLE MANAGER: *Chief, Procurement Services Branch*      STATUS: *Agree*

MANAGEMENT ACTION PLAN:      DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

*Implement managerial oversight controls to identify shipments not timely cleared from customs*

46. The audit could not quantify an average length of the custom clearance process and the prevalence and extent of custom clearance delays as this milestone has not been systematically tracked through the order tracking and inventory management systems in place during the period under review.

47. Audit testing performed revealed, however, several instances of custom clearance delays in the period under review. The average period required to clear and deliver eight orders issued in 2011 and 2012 selected for testing at three country offices visited by OAI, with a value of USD 2.3 million, was estimated by the audit team at 150 days (it should be noted that the test was initially planned for a sample of 30 orders, but reliable information could not be obtained for 22 of them, or 67 per cent of the sample size). The audit also noticed delays of up to one year, for custom clearance of significant orders issued in 2013 and 2014 in one of the countries tested. Some of the delays were attributable to factors outside the control of UNFPA (such as delays in the issuance of tax and duties exemption certificates), as well as to a lack of timely initiation of the custom clearance process (i.e., gathering documentation required to clear goods).

48. Information provided by the Finance Branch indicate that, based on inventory management system information, approximately 30 per cent of the inventory reported as in-transit as at 31 December 2013 continued to reflect that status as at 30 June 2014, further suggesting extensive delays in the release of goods from the ports of destination.

IMPACT	<i>Delays in custom clearance may result in commodity stock-outs, shortened residual shelf lives, and excessive storage and demurrage costs.</i>
ROOT CAUSE	<i>Guidance (Inadequate supervision at country/regional office and headquarters level). Guidelines (inadequate planning at country office level). Resources (lack of adequate tracking tools).</i>
CATEGORY	<i>Operational.</i>

**RECOMMENDATION 8** **PRIORITY: HIGH**

*Provide regular reports to Headquarters and Regional Office management on inventory orders with in-transit status over an extended period (i.e., for more than 90 days after financial receipt) and promptly escalate to senior management those situations where the tracking metrics indicate that appropriate remedial action has not been promptly taken.*

RESPONSIBLE MANAGER: Chief, Finance Branch STATUS: Agree  
MANAGEMENT ACTION PLAN: DUE DATE: To be determined  
*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**RECOMMENDATION 9** **PRIORITY: HIGH**

*Based on the reports provided by the Finance Branch, require Regional Offices to monitor the status of aged in-transit shipments, to provide support to country offices to resolve extended clearance delays and to address the corresponding root-causes.*

RESPONSIBLE MANAGERS: Deputy Executive Directors, Management and Programme STATUS: Agree  
MANAGEMENT ACTION PLAN: DUE DATE: To be determined  
*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**C. RECEIVING AND INSPECTION** **PARTIALLY SATISFACTORY**

*Work performed*

49. Audit work performed in this area included walk-throughs of the processes followed for receiving and inspection of shipments at the country offices visited in the course of the audit, as well as the review of evidence of receipt of goods for the sample of inventory transactions selected for testing.

*Improvement areas identified*

50. Based on the audit work performed, the audit noted the following matter that requires management attention.

Significantly enhance receiving and inspection controls

51. Receiving and inspection reports were not prepared for a large number of shipments selected for testing, and other available evidences, such as communications submitted by custom agents or logistical companies engaged by country offices, were not clear as to the extent and results of the receiving and inspection controls performed. Therefore, the audit could not determine whether appropriate receiving and inspection procedures were systematically performed by country offices: (i) upon clearance of the goods at the port of destination; and (ii) at the time of their delivery to warehouses (managed by UNFPA, implementing partners or other third parties, such as logistical services companies).

52. This issue is partially attributable to gaps in the existing guidelines. As previously mentioned in section A, the Inventory Management Policies and Procedures manual provides limited guidance on receiving and inspection controls, indicating only that “[n]ormally, a detailed Receipt and Inspection Report is prepared and signed by the receiving UNFPA staff member to document this process. Clear receipt documentation must be in place”.<sup>8</sup> The guidelines on receiving and inspection provided in the Procurement procedures and in the Receiving and Inspection Report template<sup>9</sup> however contradict the manual, stating that Receiving and Inspection Reports should only be filled if goods are not received in good order.

53. The conflicting guidelines are reiterated in the inventory management chapter of the Internal Control Framework<sup>10</sup>, which indicates that “[w]here discrepancy or damage exists, the receiving officer shall immediately perform a survey and complete and sign a Receiving and Inspection Report. .... The Receiving and Inspection Report shall be sent together with copies of the survey report and notice to the carrier to PSB as soon as possible to enable PSB to initiate an insurance claim” [emphasis added].

54. In addition, given the type and level of detail of information it requests, the Receiving and Inspection Report template, as currently designed, is not conducive to effective and comprehensive receiving control and should be better used as the template to communicate to PSB product damage and/or shortages, in order to initiate claims to manufacturers, carriers and/or insurance companies, as appropriate.

55. Finally, the guidelines provided in the Procurement procedures focus primarily on the control procedures to be performed at the time of custom clearance of goods, and do not provide detailed instructions on the more comprehensive controls that should be performed at the time of receipt of goods at a warehouse.

56. It should be noted that risk in this area is partially mitigated by pre-shipment inspection controls which are performed by third-party service providers on behalf of PSB on selected shipments.

IMPACT	<i>Goods received may not conform to those ordered. Damage, shortages and quality problems may not be timely identified.</i>
ROOT CAUSE	<i>Guidelines (inadequate corporate policies and procedures). Guidance (Inadequate supervision at country office level).</i>
CATEGORY	<i>Operational.</i>

<b>RECOMMENDATION 10</b>	<b>PRIORITY: HIGH</b>
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*Align and enhance the guidelines relative to receiving and inspection controls and completion of Receiving and Inspection Reports included in the Inventory Management Policies and Procedures manual, the Procurement procedures and the Internal Control Framework.*

RESPONSIBLE MANAGER: *Chiefs, Finance and Procurement Services Branches*      STATUS: *Agree*

MANAGEMENT ACTION PLAN:      DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report’s Executive Summary.*

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<sup>8</sup> Inventory Management policies and procedures manual – sections A.4.10 and F.2.1.

<sup>9</sup> Available at the PSB microsite.

<sup>10</sup> Sub-Processes Flowchart: Delivery of Inventory : Step - INV-010-020.

**RECOMMENDATION 11**

**PRIORITY: HIGH**

*Develop checklists and other appropriate tools to guide Inventory Focal Points in performing receiving and inspection controls: (i) upon custom clearance; and (ii) at the time of receipt of goods at a warehouse.*

RESPONSIBLE MANAGER: *Chiefs, Finance and Procurement Services Branches*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**RECOMMENDATION 12**

**PRIORITY: HIGH**

*Develop new templates for the Receiving and Inspection Report and for reporting of goods damage and shortages identified at the time of receipt of goods.*

RESPONSIBLE MANAGER: *Chief, Finance Branch*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**D. WAREHOUSE MANAGEMENT AND INVENTORY CONTROL**

**PARTIALLY SATISFACTORY**

*Work performed*

57. Audit work performed in this area included: (i) visits to warehouses managed by UNFPA and its implementing partners at the country offices covered by the audit; (ii) physical inspections and physical counts of goods held at the warehouses visited; (iii) walk-throughs of inventory controls in place at PSB, the country offices and implementing partners visited; and (iv) the review of inventory records and testing of a representative sample of inventory transactions at the same country offices and implementing partners.

*Good practices identified*

58. Inventory held by PSB with the objective of expediting order delivery is stored at vendor-managed warehouses. This inventory is adequately safeguarded and is managed effectively through the use of the Atlas inventory management module.

*Improvement areas identified*

59. Based on the audit work performed, the audit noted the following matter that requires management attention.

*Provide information and tools for monitoring the effectiveness of warehouse management and inventory controls*

60. Warehouse visits conducted in the course of the audit revealed that there were generally adequate controls in place for physical safeguarding of inventory under the control of both UNFPA and the implementing partners to which the inventory was handed-over. The audit noted, however, a number of warehouse management and inventory control gaps which, while not defining a trend, require remedial action.

61. With regards to warehouse management, some instances were noted where: (i) warehouse facilities were in need of physical enhancement; (ii) inventory storage space layout could be improved for better storage conditions and ease of access to the goods; (iii) inventory was not clearly identified by product and batch number or expiration date; and (iv) goods were not delivered on a first-in, first-out basis. With regards to inventory control, cases were noted where: (i) records were not timely updated to reflect receipts and deliveries; and (ii) physical counts were not regularly performed, and results thereof not reconciled to accounting records. Recommendations were directly provided to the concerned country offices to enhance their practices in this area or to contribute to developing capacity of those implementing partners impacted by the gaps noted, as appropriate.

62. Audit work revealed a matter of concern regarding the existence in five different countries and at different points in the period under review, of damaged and expired, or about to expire, goods and of unreconciled inventory differences at warehouses managed by UNFPA or implementing partners, for a total of approximately USD 0.9 million, 50 per cent of which corresponds to inventory held by the Ministry of Health in one programme country. While, given the large volume of inventory handled, it is unavoidable that a certain (limited) level of inventory will be lost or damaged, additional controls are required to minimize losses while goods remained under storage and, in particular, to ensure that goods are distributed well ahead of their expiration dates.

63. It should be noted that, as from 2014, country offices are required to perform and reconcile physical inventories and certify inventory balances on a quarterly basis, which should contribute to a timelier identification and remediation of issues affecting inventory under UNFPA control.

IMPACT	<i>Inventory may get damaged, lost or wasted due to inadequate warehouse management practices and inventory controls.</i>
ROOT CAUSE	<i>Guidance (Inadequate supervision at country office level).</i>
CATEGORY	<i>Operational.</i>

<b>RECOMMENDATION 13</b>	<b>PRIORITY: HIGH</b>
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*Define and provide regular reports to headquarters and regional office management on key indicators on effectiveness of warehouse management practices and inventory controls, such as (i) level, ageing and remaining shelf-life of inventory held at warehouses under UNFPA control; (ii) level and value of damaged and expired /soon-to expire inventory; and (iii) amount of inventory differences and adjustments. Promptly escalate to headquarters and regional office management those situations where metrics reveal red flags indicative of inventory management effectiveness issues.*

<u>RESPONSIBLE MANAGER:</u> <i>Chief, Finance Branch</i>	<u>STATUS:</u> <i>Agree</i>
<u>MANAGEMENT ACTION PLAN:</u>	<u>DUE DATE:</u> <i>To be determined</i>

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

<b>RECOMMENDATION 14</b>	<b>PRIORITY: HIGH</b>
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*Develop tools for use by country offices to monitor warehouse management practices and inventory controls at warehouses managed by either UNFPA country offices or by implementing partners.*

<u>RESPONSIBLE MANAGER:</u> <i>Chief, Finance Branch</i>	<u>STATUS:</u> <i>Agree</i>
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MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**RECOMMENDATION 15**

**PRIORITY: HIGH**

*Require country offices to: (i) monitor key indicators of effectiveness of implementing partner warehouse management and inventory controls (including inventory levels, ageing and remaining shelf-life of inventory, quantity and value of damaged and expired goods, and inventory differences and adjustments) based on the review of information from national logistical management systems, warehouse visits, physical inventories and other appropriate monitoring activities; (ii) provide support to implementing partners to address issues identified; and (iii) report to regional offices on the outcome of monitoring and remedial actions taken.*

RESPONSIBLE MANAGER: *Deputy Executive Directors, Management and Programme*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**RECOMMENDATION 16**

**PRIORITY: HIGH**

*Require regional offices to regularly monitor the inventory management metrics reported by the Finance Branch and by country offices, and to provide support to address capacity gaps affecting the effectiveness of warehouse management practices and inventory controls by UNFPA country offices and implementing partners.*

RESPONSIBLE MANAGER: *Deputy Executive Directors, Management and Programme*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**E. DELIVERY AND DISTRIBUTION**

**UNSATISFACTORY**

*Work performed*

64. Audit work performed in this area included: (i) the inspection of documentary evidence of delivery and distribution of inventory by the UNFPA country offices and implementing partners visited in the course of the audit; (ii) the review of the results of commodity availability surveys undertaken by countries supported by the GPRHCS; and (iii) the tracking of a representative sample of shipments along the downstream supply-chain, up to their receipt by beneficiary health facilities.

*Good practices identified*

65. Commodity availability surveys, which are regularly completed for countries supported by the GPRHCS, measure commodity availability and stock-out levels. They also highlight problems affecting the logistical systems, providing invaluable evidence that can be used by UNFPA country offices and implementing partners to enhance the effectiveness of their inventory management processes.

*Improvement areas identified*

66. Based on the audit work performed, the audit noted the following matters that require management attention.

*Consistently document transfer of control over inventory to implementing partners*

67. The audit noted that, although the guidance provided in the Inventory Management Policies and Procedures manual is clear, Inventory Receipt forms are not systematically prepared and signed by implementing partners to provide evidence of hand-over of goods, either when transferred immediately after completion of custom clearance procedures or when issued from UNFPA managed warehouses.

68. As from 2014, the Finance Branch started to track inventory deliveries reported by country offices against the corresponding hand-over forms, signed copies of which are required to be scanned and uploaded in the inventory management system. The Finance Branch ability to track deliveries will be further enhanced following the implementation of Shipment Tracking System.

69. No separate recommendation is made as regards this matter, in consideration of the actions already taken by the Finance Branch and upon satisfactory implementation of recommendation number 13 (above) related to regular reporting and monitoring of in-transit and on-hand inventory, which would allow the identification of inventory transfers incompletely documented.

IMPACT	<i>Transfer of control over inventory may not be clearly evidenced and UNFPA may retain the risk related to ownership of the goods transferred. Inventory balances may be misstated due to lack of recording deliveries.</i>
ROOT CAUSE	<i>Guidance (Lack of supervision at country office level).</i>
CATEGORY	<i>Operational.</i>

*Monitor inventory distribution and availability on a regular basis*

70. The audit noted that, during the period under review, country offices monitored in a limited way the distribution of inventory by implementing partners, depriving management of an essential tool for obtaining assurance that inventory was timely and effectively distributed to the beneficiary facilities and for discharging UNFPA's fiduciary accountability to donors.

71. In some instances, country office involvement in the distribution process was limited to participating and/or supporting the preparation and approval of distribution plans in conjunction with key programme stakeholders at national and/or state level, with limited or no follow-up on the implementation of said distribution plans and the receipt of commodities by beneficiary health facilities.

72. Visits to warehouse and health facilities as well as the review of information from national logistical management systems revealed instances where inventory remained undistributed for extended periods of time or was distributed at a slow pace. This also exposed instances of lack of commodity availability and of stock-outs of varying magnitude. While not indicative of a trend, these issues nevertheless require management attention to put in place appropriate remedial action.

73. Limitations to commodity availability and stock-out levels are routinely measured through annual commodity availability surveys completed for the GPRHCS priority countries,<sup>11</sup> the results of which are disclosed, in summarized format, in the GPRHCS annual reports.

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<sup>11</sup> For some countries, these surveys were completed for the first time in 2014, following the programme scope expansion.



74. While the surveys reflect significant progress in many of the countries supported, they continue to attribute commodity availability issues and stock-outs to delays in the resupply of health facilities by the designated warehouses, emphasizing the importance of maintaining regular monitoring of the downstream supply-chain and of the distribution process (i.e., the “last mile”) to enable more timely identification and resolution of logistical problems.

75. The Inventory Management Policy and Procedures manual, the logistics section of the Procurement procedures and the different programming policies and procedures do not provide guidelines on how to monitor the distribution of reproductive health commodities and other inventory items beyond the point of hand-over to implementing partners. In addition, the audit noted a mindset by some programme managers in country offices that UNFPA’s responsibility ends at the time of inventory hand-over to implementing partners.

IMPACT	<i>Downstream supply-chain and distribution issues might not be timely identified and addressed resulting in commodity availability issues and increased stock-out levels. Inventory supplied may not be used for the intended purpose. More limited ability to effectively discharge fiduciary accountability to donors.</i>
ROOT CAUSE	<i>Guidelines (lack of clear corporate guidelines). Guidance (Lack of supervision at country office level).</i>
CATEGORY	<i>Operational.</i>

**RECOMMENDATION 17**

**PRIORITY: HIGH**

*Develop guidelines and tools and require country offices to: (i) monitor the timeliness and effectiveness of inventory distribution, including regular tracking of key metrics such as percentage of execution of distribution plans and inventory levels held at service delivery points; (ii) provide support to implementing partners to address issues identified; and (iii) report to regional offices on the outcome of monitoring and remedial actions taken.*

RESPONSIBLE MANAGER: *Deputy Executive Directors, Management and Programme*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report’s Executive Summary.*

**RECOMMENDATION 18**

**PRIORITY: HIGH**

*Based on reports provided by country offices, require regional offices to monitor the effectiveness of inventory distribution and support country offices’ efforts to address implementing partner capacity gaps that could impact product availability at service delivery points.*

RESPONSIBLE MANAGER: *Deputy Executive Directors, Management and Programme*

STATUS: *Agree*

MANAGEMENT ACTION PLAN:

DUE DATE: *To be determined*

*Refer to the response reflected in paragraphs 18 to 22 of the report’s Executive Summary.*

**RECOMMENDATION 19**

**PRIORITY: HIGH**

*Expand the scope of IP assurance activities (i.e., NEX audits and HACT audits and spot-checks) to cover inventory supplied to implementing partners, to obtain increased assurance that goods were appropriately and timely distributed.*

RESPONSIBLE MANAGER: Deputy Executive Directors, Management      STATUS: Agree

MANAGEMENT ACTION PLAN:      DUE DATE: To be determined

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

**F. INVENTORY ACCOUNTING AND REPORTING**

**SATISFACTORY**

*Work performed*

76. Audit work performed in this area included: (i) a walk-through of the functionality of the inventory system used throughout the period covered by the audit, of the replacement system that will be implemented in 2015, and of the controls in place to ensure an accurate and complete identification, valuation and reporting of inventory balances; and (ii) the testing of inventory balances reported as of 1 January and 31 December 2012.

77. No work was performed on the identification and valuation of inventory as of 31 December 2013, as this process was reviewed by the United Nations Board of Auditors as part of their external audit of the financial statements of UNFPA for 2013.

*Good practices identified*

78. UNFPA implemented, as from early 2012, the process required to determine and report inventory balances in accordance with IPSAS. Although still highly reliant on manual activities and controls, the process implemented allowed UNFPA to accurately identify, value and report inventory under control of UNFPA country offices, including in-transit inventory. Enhancements were introduced to the inventory management system in 2013 and 2014, incorporating lessons learned during the period under review. Further enhancements are planned for 2015, including the implementation of a new system that will provide better functionality for operational tracking and control of inventory and provide an improved basis for inventory valuation and financial reporting.

*Improvement areas identified*

79. Based on the audit work performed, the audit noted the following matters that require management attention.

Promptly release into production the new Atlas Shipment Tracking module

80. Country offices utilized CHANNEL to track and report inventory under their control during the period under review.

81. Initially, in 2012, only twelve country offices were authorized by headquarters to hold inventory at UNFPA-managed warehouses and were therefore required to use CHANNEL (which was not integrated to Atlas) for recording inventory receipts and shipments and for on-hand and in-transit inventory control and valuation. All other offices were only required to reflect in CHANNEL inventory in-transit at the year-end, for financial reporting purposes. The value of in-transit inventory was identified based on the analysis, by country offices, of the status of inventory orders issued in the last quarter of the year. The inventory valuation for the UNFPA financial statements was done manually by the Finance Branch.

82. All offices were also required to use CHANNEL to track and report on-hand and in-transit inventory as from 2013, and to generate earmarking and hand-over forms (i.e., inventory receipt forms) directly from the system. Further enhancements were made in 2014, including the uploading of all PSB inventory orders through a monthly Atlas interface.

83. In spite of the capacity building efforts undertaken by the Finance Branch, the audit noted that during the period under review, several country offices did not use CHANNEL effectively, particularly to track in-transit inventory. Some offices used manual in lieu-of system-generated hand-over forms or, as previously mentioned, did not document inventory hand-over altogether. In some cases, physical inventory adjustments were not promptly reflected in the system. The audit also noted instances where locally procured inventory items, such as hygiene and dignity kits, were not controlled through the use of CHANNEL. The audit further revealed other gaps, such as not fully reflecting inventory on-hand at the time the system was implemented. Similar concerns were raised by the United Nations Board of Auditors as a result of their external audits of UNFPA’s financial statements.

84. The impact of the above issues has been minimized through extensive supervision and review by the Finance Branch, to ensure an accurate valuation and financial reporting of year-end inventory balances. Country offices are now required to perform physical counts and certify CHANNEL inventory balances on a quarterly basis. In addition, transfers of inventory to implementing partners are validated against the corresponding hand-over forms.

85. Per the Finance Branch, inventory control, valuation and reporting will be supported through a new Atlas based Shipment Tracking System, which will replace CHANNEL in 2015. This system, built as an extension of the Atlas receipt module, was undergoing user acceptance testing at the time of issuance of the draft audit report.

86. The Shipment Tracking System will be automatically fed with all inventory orders issued by PSB throughout the year and will reflect key process milestones, such as goods’ financial and physical receipt and the earmarking, hand-over and/or issuance of goods to implementing partners. Milestones tracked through the Shipment Tracking System will be automatically updated in the Order Management System. Additional milestones will be reflected and tracked upon implementation of a planned second version of the system, expected to take place the following year (2016).

87. In addition, the system will be used to control, value and report the inventory that remains under the control of UNFPA country offices or is in transit. Per the Finance Branch, it is not foreseen -at this time- that the system will be used to control, value and report inventory locally procured by country offices, for which alternative tools (e.g. spreadsheets) will have to be utilized.

IMPACT	<i>The ability to track inventory, for operational and financial reporting purposes, may be diminished.</i>
ROOT CAUSE	<i>Resources (lack of training and of integrated systems). Guidance (inadequate supervision at the Office level).</i>
CATEGORY	<i>Operational.</i>

**RECOMMENDATION 20** **PRIORITY: MEDIUM**

*Enhance the functionality of the Atlas-based Shipment Tracking System to be implemented in 2015 to make it the “go-to” system for inventory tracking and control, expanding its use to cover inventory procured directly by country offices and providing the capability to track all key downstream supply-chain milestones, including those currently reported by vendors through the order tracking system.*

RESPONSIBLE MANAGER: Chief, Finance Branch

STATUS: Agree

MANAGEMENT ACTION PLAN:

DUE DATE: To be determined

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

Expense inventory procured at the time of hand-over to implementing partners

88. Even after implementing IPSAS, UNFPA continued to expense the cost of inventory procured at the time it is financially received, i.e., when UNFPA takes control of inventory which, for internationally procured goods (which represent the bulk of inventory procurement) occurs at the time the products are shipped to their destination. At the year-end, the cost of the inventory that remains under UNFPA control (i.e., not delivered to its intended beneficiaries) is capitalized, by reversing the expenses recognized at the time the products were shipped and charging the appropriate inventory asset accounts.

89. This accounting procedure allows UNFPA to determine and report inventory balances in accordance with IPSAS at the end of each fiscal year, but limits the Organization's ability to quantify and report the value of inventory (in-transit and on-hand) at interim periods. The latter could be achieved through the use of general ledger control accounts charged with the cost of inventory at the time it is shipped, and credited when control over inventory is transferred to implementing partners and beneficiaries, at the time it is delivered to them.

90. In addition, the current accounting procedure distorts the status of programme implementation during the year, as activities related to the supply of inventory are considered as implemented and reflected in the programme implementation rate at the time the goods are shipped instead of when goods are delivered to implementing partners. This diminishes the value of programme implementation rate as a metric to monitor programmatic performance and also does not foster programme managers to follow up on timely clearance and delivery of goods to implementing partners.

IMPACT	<i>Limited ability to determine the value of inventory balances and inaccurate measurement of implementation status throughout the year.</i>
ROOT CAUSE	<i>Guidelines (inadequate corporate policies or procedures). Resources (lack of adequate systems).</i>
CATEGORY	<i>Reporting.</i>

**RECOMMENDATION 21**

**PRIORITY: HIGH**

*Implement the process and system changes required to account for inventory through the use of general ledger control accounts for in-transit and on-hand inventory, and to expense the cost of inventory only at the time it is physically delivered to implementing partners or beneficiaries.*

RESPONSIBLE MANAGER: Chief, Finance Branch

STATUS: Agree

MANAGEMENT ACTION PLAN:

DUE DATE: To be determined

*Refer to the response reflected in paragraphs 18 to 22 of the report's Executive Summary.*

## ANNEX 1

### Definition of Audit Terms

#### A. AUDIT RATINGS

Effective 1 January 2010, the internal audit services of UNDP, UNFPA, UNICEF, UNOPS and WFP use revised harmonized audit rating definitions, as described below:

- **Satisfactory** – governance, risk management and internal controls processes were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.
- **Partially Satisfactory** - governance, risk management and internal controls processes were adequately established and functioning well. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.
- **Unsatisfactory** - governance, risk management and internal controls processes were either not established or functioning well. The issues were such that the achievement of the objectives of the audited entity could be seriously compromised.

#### B. CATEGORIES OF ROOT CAUSES AND AUDIT ISSUES

- **Guidelines:** absence of written procedures to guide staff in performing their functions:
  - Lack of or inadequate corporate policies or procedures
  - Lack of or inadequate Regional and/or Country Office policies or procedures
  - Inadequate planning
  - Inadequate risk management processes
  - Inadequate management structure
- **Guidance:** inadequate or lack of supervision by supervisors:
  - Lack of or inadequate guidance or supervision at the Headquarters and/or Regional and Country Office level
  - Inadequate oversight by Headquarters
- **Resources:** insufficient resources (funds, skills, staff) to carry out an activity or function:
  - Lack of or insufficient resources: financial, human, or technical resources
  - Inadequate training
- **Human error:** Un-intentional mistakes committed by staff entrusted to perform assigned functions.
- **Intentional:** intentional overriding of internal controls.
- **Other:** Factors beyond the control of UNFPA.

### C. PRIORITIES OF AUDIT RECOMMENDATIONS

Audit recommendations are categorized according to their priority, as a further guide to management in addressing the related issues in a timely manner. The following categories of priorities are used:

- **High:** Prompt action is considered imperative to ensure that UNFPA is not exposed to high risks (that is, where failure to take action could result in critical or major consequences for the organization);
- **Medium:** Action is considered necessary to avoid exposure to significant risks (that is, where failure to take action could result in significant consequences);
- **Low:** Action is desirable and should result in enhanced control or better value for money. Low priority recommendations, if any, are discussed by the audit team directly with the management of the audited entity during the course of the audit or through a separate memorandum upon issued upon completion of fieldwork, and not included in the audit report.

### D. CATEGORIES OF ACHIEVEMENT OF OBJECTIVES

These categories are based on the COSO framework and derived from the INTOSAI GOV-9100 Guide for Internal Control Framework in the Public Sector and INTOSAI GOV-9130 ERM in the Public Sector.

- **Strategic:** High level goals, aligned with and supporting the entity's mission.
- **Operational:** Executing orderly, ethical, economical, efficient and effective operations and safeguarding resources against loss, misuse and damage.
- **Reporting:** Reliability of reporting, including fulfilling accountability obligations.
- **Compliance:** Compliance with prescribed UNFPA regulations, rules and procedures, including acting in accordance with Government Body decisions, as well as agreement specific provisions.

## GLOSSARY

CSB	Commodity Security Branch
CHANNEL	Inventory management system used by UNFPA from 2012 to 2014
FB	Finance Branch
GPRHCS	Global Programme to Enhance Reproductive Health Commodity Security
HACT	Harmonized Approach to Cash Transfers
HQ	Headquarters
IPSAS	International Public Sector Accounting Standards
NEX	National Execution
OAIS	Office of Audit and Investigation Services
OTS	Order Tracking System
PSB	Procurement Services Branch
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNFPA	United Nations Population Fund
USD	United States Dollars
WFP	World Food Programme