



Internal Audit Annual Report

2017/2018

August 2018

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A. Internal audit function - period in review

Over the past 12 months the internal audit function has been fortunate enough to have a period of stability with no staff turnover. This coupled with improvements in the planning process for audits enabled the team to conduct over ten audits including some of the biggest and more contextually challenging country programmes. Awareness of the function continues to grow amongst the international operations but it is also recognised that more work needs to be done to improve the understanding of the function's objectives and ways of working.

The internal audit staff met in September 2017 in Copenhagen for a team meeting in conjunction with the Dfine event. The meeting gave the team the opportunity to be updated on the policy developments of DRC and to discuss the issues impacting the internal audit function. One main topic of discussion was how the function can better engage management in addressing the findings from the audits. This is an ongoing discussion and several strategies are being explored in collaboration with senior management.

The internal audit feedback questionnaire that was implemented in 2016 continues to be distributed to operations post the issuing of the final internal audit report. The responses to the questionnaire were communicated to the internal audit sounding board in the January 2018 meeting. Generally, the feedback has been positive. Areas where there is a need for internal audit to address include providing more information on the audit process and objectives, clarifying roles and responsibilities during the audit process and also assisting in building staff awareness of the differences between risk management, compliance reviews, operational support and development, and internal audits. Improvements on the feedback process also exist, especially regarding the number of responses and identifying reasons why operations did not provide feedback.

A new report format was launched during the period. It is hoped that the changes will provide users of the reports with more clarity on the issues identified and assist in providing focus. The format also tries to better engage the reader through the physical appearance of the report and flow of information. Other initiatives implemented during the period include a presentation on the internal audit process which is available on Insite and the introduction of standardised opinions. Through the use of the standardised opinions it is hoped that management will be better informed of matters that require their attention.

Unfortunately, during the period, the occurrence of internal audit sounding board meetings has been limited to just two. These meetings have primarily had a focus on the matter of improving management engagement. In the January 2018 meeting the annual cycle for the internal audit function was also discussed. It was agreed that the annual cycle should change back to a calendar year. This would then align the function with the other strategic planning and budgeting cycles of DRC. It would also enable management to include in their planning the findings from the annual internal audit report.

B. Introduction

The annual report covers audits completed since the issuing of the previous annual report and is therefore not aligned directly with the annual plan. The report represents an overview of the common key findings from those audits. It includes audits conducted over 12 months ago and consequently some of the findings may no longer be relevant or have been addressed through the implementation of the recommendations or other initiatives. But for completeness the findings are still included in the report. When developing the conclusions, developments in policies and processes during the period covered by the report, have been considered so that the focus is on those risks and matters that remain.

Due to the change in the annual cycle for the internal audit function there are several more country audits covered in this report. Below are the audits covered by the report (no region office audits were conducted during the period):

Country	Thematic
Iran	Safety and Security
Iraq	
Myanmar	
Nigeria	
Somalia	
South Caucasus	
South Sudan	
Sudan	
Syria	
Tanzania Emergency Programme	

Due to the generalisation of the findings the reader should not conclude that all findings stated in the report existed in each of the operations audited. The report's intent is to inform the reader of risks that require management's attention to ensure that DRC is appropriately managing those risks.

Additional Work

In early 2018 the internal audit function was requested to conduct a review of the donor audit processes of DRC when applied at an organisational level. This request was in response to the ECHO audit and significantly high number of initial findings from the auditors. The review was conducted during February and a report issued to the Chief Finance Officer who was the sponsor of the review.

Internal audit staff continued to support the code of conduct team in HQ by conducting several investigations during the period.

The team has also been providing support to the ERP program as user reference group, working group and portfolio board members. In addition to the direct support, advice has also been provided in the development of policies linked to the ERP program.

The report does not include any findings from this additional work. However organisational developments identified while conducting the additional work have been considered when developing the conclusions.

C. Key Findings

1. Country programme audits

The key findings from the country programme audits have been grouped under the main process functions or themes.

Code of Conduct Management

Consistency in the implementation of the Code of Conduct and reporting mechanism varies between country operations. There continues to be some underlying gaps in the understanding and compliance with the policies especially regarding the reporting of suspicions of breaches and the investigation process. It is evident that this occurs at all levels of management and the culture of respecting the policies needs to be further nurtured by senior management so that it can be disseminated through the management structure.

The impacts resulting from the gaps in compliance and respect for the policies have included staff not having trust in the processes, cases not being reported, staff unfairly treated because due process has not been followed and a loss of funds. One finding that appears to be a cause of these impacts is the interference of management in the processes. This mainly transpires in two forms. The first is through a belief that they should be informed of all cases and have continuous updates on the progress of investigations even though they are not the authorising officer. This interference can make it difficult to ensure due process is achieved and that confidentiality is maintained. The second is the actions taken both prior and after an investigation which are not consistent or do not appear appropriate in the context.

Staff awareness and understanding of the Code of Conduct is not satisfactory across all operations audited. A common cause of this is due to a lack of sufficient training provided to staff on the Code of Conduct and reporting process. There was evidence that staff have signed the Code of Conduct but very little to support that all staff understood what they were signing. The Code of Conduct team in HQ has provided support where possible to address this issue but more needs to be done at all levels and management need to ensure resources are available to meet those training needs.

It appears the main focus of the Code of Conduct continues to be on the internal application and not with external stakeholders. Beneficiary feedback or complaints mechanisms are rare amongst operations, although there were some good examples of reporting mechanisms being established and utilised by beneficiaries. However, in other operations where they do exist, there were examples of the mechanisms not being managed appropriately. Contextual factors can impact on this but DRC must remain diligent and ensure that all actions that can be taken have been.

Compliance with Local Laws and Regulations

All the operations audited have engaged legal professionals to some degree to provide advice on the legal status and requirements of DRC in the country of operation. Further, legally binding documents were generally reviewed by legal professionals before their use in the operations. There were however a few examples where revisions to the documents had not been reviewed and this could pose a risk to DRC.

The main area of risk and concern is the application of local laws and regulations to DRC and the challenges in getting clarity on this from authorities. In many of the contexts DRC works in there is ongoing development of the legislative environment and therefore it is important that DRC management keep abreast of the changes and how they can impact operations. This can however be challenging when inconsistent and unsubstantiated advice and information is provided by legal advisors and the authorities themselves. Notwithstanding these challenges DRC should strive to ensure compliance where it is possible and not impeding on achieving its humanitarian imperative. There have been some instances where this has not been the case and an approach of operating in the grey areas has prevailed.

Another area of concern that has developed significantly in the past few years relates to the tax status of DRC and its employees in the varying countries of operation. Tax legislation can be complex at the best of times and negotiating it generally requires specialist advice. In some operations this has been sought in good time and the operations have been dually compliant in their tax obligations. But in others there is a considerable risk of incurring fines due to the possibility of DRC not being compliant.

The engagement of service providers to facilitate the processing of visa applications, work permits, registrations, travel permits etc. has become necessary in some contexts. The services they provide can be vital to ensuring that DRC has the authority and access to operate in the locations of greatest need. Management need to ensure that such relationships do not pose any risk to DRC and if risks are identified that contingency measures are put in place to manage the potential impact.

Supply Chain Management

The awareness and understanding of the supply chain policies and processes is not consistently at the level required to ensure that risks are being appropriately managed across all country operations. One key finding that appears to be a cause for this issue is the lack of stable leadership in some operations. High turnover of key staff or the wrong capacity for the context are examples of the reasons that have resulted in a lack of leadership. Junior staff or staff new to DRC are therefore not provided the guidance and training they need to understand the policies and procedures of DRC and how to implement and comply with them.

Beyond the issues with awareness and understanding of the supply chain policies, general compliance with the policies continues to be an issue for most operations audited. The level of non-compliance can vary from minor to rather considerable, exposing DRC to significant risks. Generally, an overall desire and recognition by all staff of the importance to be compliant needs to be improved. This includes a realisation that continual investment in supply chain management through ensuring the existence of sufficient resources and capacities is necessary.

Several operations had implemented additional controls beyond those required by DRC's policies. Unfortunately, in most circumstances the additional controls were counterproductive and either made the overall process less efficient or didn't actually mitigate the risks as intended. Generally, this demonstrated a lack of understanding of the processes and roles and responsibilities. However, it was also evident that in some operations it was not due to a lack of understanding but acceptance and recognition of an individual's role and responsibilities. A lack of procurement plans, order requests incorrectly filled in or not complete and approvals given for non-compliant documentation were examples identified of this.

The disproportionate and inappropriate use of derogations remains an issue that needs to be addressed by DRC at an organisational level. In a couple of operations derogations appeared to be the main procurement process utilised and often exposed DRC to several risks. Where derogations have been found to be appropriately used, due to the context, there were examples of weak execution. There remains a culture in some parts of the organisation where the use of derogations is accepted as the norm and not as the exception.

Although the use of warehouses in DRC's operations is relatively limited and generally only in the implementation of emergency responses, there are instances where a reasonable value of stock is being stored. Several of the facilities utilised to store these stocks were visited during the audits. The quality of the warehouse management varied significantly. Examples of well organised and documented stock warehousing existed. There was also evidence of policy compliant releasing of stock from the warehouses. Within the supply chain strategy developed in 2017, warehousing was identified as an area that requires global expertise to develop the policies and procedures. This has been addressed and a new warehousing policy has been developed and released for operations to implement. The policy will be further supported by DRC Dynamics which includes warehousing under the supply chain module.

Partner Management

The engagement with other organisations by DRC's operations in the implementation of projects takes on several forms but the main form of engagement, historically, has tended to appear more as contracted service providers. More recently partnership arrangements, of the form generally referred to within the INGO sector, have started to exist, prompted mainly by donors but also local authorities who want to reduce the dependency on international organisations. DRC has therefore been required to develop policies and processes to assist operations in the management of partnerships. The partner management policy was implemented in early 2017 and has slowly been operationalised in the countries where partnerships exist.

Working with partner organisations can increase the risk environment of DRC mainly due to the loss of full control of implementation of project activities. It requires additional monitoring, support and communication processes to be in place and diligence by staff to follow them. Unfortunately, this was not present in several of the country operations audited where an engagement with partners existed. Monitoring of the partners by DRC staff was either non-existent, poorly documented or not timely to address identified issues.

The initial stages of engagement with partners was also an area of weakness in many operations. Proper assessments of partner organisations had not been completed or were not satisfactory to meet the objectives of the process. Very few assessments included a vetting process especially in regard to terrorism which is a requirement of several donors and a high risk for DRC. Where assessments had been conducted they were not always utilised adequately to identify development needs and resource gaps.

Safety Management

General compliance with the safety policies of DRC appears to be good across the country operations. There were however several isolated instances of non-compliance or a need for significant improvement identified during the audits. These concentrated mainly on the infrequent updating of documentation and safety assessments. But there were also isolated

instances where key processes or documentation did not exist exposing DRC staff to considerable risks.

Occasionally the non-compliance was due to a lack of resources or capacities. More concerning was that in some of the highest safety risk locations DRC operates in this was most pronounced. The lack of resources has also impacted on the ability of operations to ensure staff have received safety training adequate to the threat level of their location of work. The funding of safety costs is generally something that donors are happy to accept and DRC needs to make a bigger effort ensuring that budgets include sufficient funding to be used for safety costs. In the absence of this funding, management need to recognise their duty of care responsibilities and not leave operations isolated in identifying funding to cover safety related costs.

What has been evident when safety management has been audited is the disparity in application of policies between national and international staff. Not all operations provide national staff with health and work place injury insurance and instead rely on local health systems which can at times be insufficient. There were also instances where international staff were not approved to travel or work in a particular location but national staff were. This is not necessarily an issue in itself, but due to the non-discriminatory nature of the threat all staff were at risk and therefore the same processes and restrictions should have applied. It is broadly recognised that the threat level for some safety risks can be lower for national staff. Management need to ensure they are not complacent when assessing this and understand the factors, and most importantly when these factors don't exist, which contribute to the reduced threat level for national staff.

Finance Management

There has been a perception in many operations and at each level of management that the finance function are the gatekeepers for ensuring compliance with donor requirements. Although finance do have a role and responsibilities there needs to be a recognition that they do not have ultimate responsibility. Unfortunately, in many operations this is not the situation and as a result the finance function has introduced additional processes and controls to ensure that their perceived responsibility can be achieved. While the intentions are good, operations need to ensure that all staff recognise, understand and comply with their responsibilities. Having the additional processes and controls can be prohibitive to the efficient implementation of activities and therefore consideration also needs to be given to whether the benefits outweigh the negatives.

An impact of the misperception of the finance function's responsibilities is regarding the maintenance of sufficient supporting documentation. In several operations supporting documents are copied and then filed multiple times which is inefficient. In other operations there is confusion over who has responsibility and therefore the risk that not all required documentation is maintained exists. The policies and processes of DRC are clear enough to identify the responsibilities of the different functions. The transfer of responsibilities from one function to another to address shortfalls in those responsibilities being met should be avoided and instead the functions held accountable.

Overall the compliance with DRC policies and processes is good in the operations audited. Some examples of non-compliance included insufficient bank signatories, a lack of proper monitoring and management of cash advances, cash handling processes that did not ensure all risks were being addressed and incorrect recording of some transactions in the cashbooks. Many of these can be addressed quickly by the operations and do not require additional

resources or capacities. However, in some operations a lack of resources and capacities in the finance function was one of the causes identified resulting in the instances of non-compliance.

HR Management

The realisation of a previously identified risk in the Turkey country programme resulting in a substantial fine in early 2017 prompted the internal audit function to focus more on the associated risks with country operations being compliant with local labour laws. Unfortunately, although considerable work has been performed over the past 18 months there are still several examples of potential non-compliance in the countries audited. Some of the issues noted stem from the context and difficulty in getting clarity from the authorities on how the labour laws apply to DRC and its staff. However, there were other instances where the potential non-compliance was due to factors that were under the full control of the country operation.

One particular area of concern is regarding the legitimacy of employment contracts utilised by DRC both in their compliance with local labour laws and application dependent on the employment status of individuals. Too often staff in some operations have been employed under an employment status to avoid complying with elements of local labour laws. One example of this was the offering of service contracts to individuals to avoid a lengthy recruitment and approval process involving authorities. While some practices may be acceptable in exceptional circumstances and on a short-term basis, they have unfortunately become the norm in some operations.

The tax status of staff was an area resulting in instances of questionable compliance across several country operations. This involved both national and international staff though when regarding national staff the issues mainly existed due to unclear information from authorities. For the international staff where, questionable compliance existed it was in several cases due to DRC trying to circumvent the visa and work permit requirements of a country to employ expatriate staff or where insufficient effort had been made to ensure the tax status of international staff had been clarified.

Several issues were noted when reviewing staff files during the audits. Many instances of required documentation not existing were noted, but key documents (contracts, termination letters, contract extension letters) were more consistently present. Some offices did express confusion over which documentation was required to be filed and the manner and location in which it should be filed (digitally, hard copies, country office/HQ). On the whole the documentation was satisfactory but staff need to be diligent as there were a couple of instances where missing documentation has impacted DRC's operations.

The absence of sufficient payroll systems appropriate to the size and complexity of operations remains an issue for many of DRC's operations. There were also examples of payroll systems existing but not effectively being utilised and therefore the associated risks still remaining. Many operations had hoped that the ERP system would address the payroll system issue but due to the complexity of having a payroll system sufficient to meet the requirements of all countries DRC operates in, it has been deemed out of scope. Therefore, the international operations need to consider how to address the situation.

The lack and inconsistency of staff development and training opportunities in many operations was stated numerous times as reasons for staff turnover and poor morale. A Development policy, as part of the operations handbook, was released in early 2018. The policy however

does not go into the details for implementation to ensure consistent application across operations. Management are therefore left to make the decisions themselves. This can lead to a disparity in the opportunities provided and often are dictated by the availability of funding. Therefore, in resource constraint operations the opportunities are low. In some operations this is evident even in the simple and necessary application of providing a proper onboarding process.

Program management

One finding that has highlighted several risks has been regarding the management structures of the individual country operations. These structures can vary considerably from country to country. Several factors impact on the structures including, size of programme, location of offices, accessibility to locations, presence of international staff and availability of funds. When conducting the audits, the focus of internal audit regarding management structures has been on where the structure is resulting in the existence of risks and not on defining a universal structure. Therefore, the risks that have been identified include, confusion over management lines, confusion in roles and responsibilities, duplication of work, insufficient resources or misaligned staff resource allocations compared to the needs, and inadequate leadership and management of staff.

During 2018 the HR department utilised Mercer's International Position Evaluation (IPE) methodology to assist the international operations in developing a more standardised approach to management structures. It is envisaged that several of the findings from the audits will be addressed through this process. Country operations do however need to be mindful that roles and responsibilities are defined and reasonable based on the positions they have in their structures. There is a risk that some positions will become untenable because of the breadth of responsibilities assigned to them and the lack of support structures surrounding them.

The main finding in this key risk area however is in relation to the lack of sufficient and systematic budget management processes in all the operations audited. The issues identified can be characterised in two broad categories. The first is a failure by staff and management to understand and recognise individual roles and responsibilities in budget management. The second is a lack of capacities and resources to support the processes. This can be broken down further to include issues related to staff not having the necessary skills and sufficient and timely information not being available.

Finance are too often seen as having the sole responsibility to manage budgets and this is incorrect. Unfortunately, management at all levels do not always recognise the implications of this and therefore have to date not been active in dissuading this misconception. It should be said that the funding structure of DRC and the approach to the management and recognition of projects nurtures this environment. Therefore, the realignment of roles and responsibilities regarding budget management will not solely address the risks. It will require a broader and significant change in the project management approach and funding structure of DRC.

The distribution of aid is a procedure that requires several key controls to be in place so that DRC can demonstrate to donors, and other stakeholders, that they have achieved the objectives for which funding has been provided. One key process to enable this is the use of distribution lists and unfortunately in several operations the maintenance of this key evidence has been weak. Examples of issues identified included a lack of reconciliations being conducted, incomplete distribution lists, no distribution lists and poor secure filing of

documentation that contained sensitive personal data. The issues with the distribution process has further been echoed by multiple audit findings from several donor audits. Regrettably, it is unclear who in DRC has ownership of the distribution process and therefore the mandate to address the issues.

Cash Programming

With the growth in cash programming as a preferred tool for interventions, though traditionally within the livelihood sector, it is vital that DRC has sufficient policies and processes in place to appropriately manage the associated risks. Cash programming existed in several of the country programmes that were audited and all of them had findings that needed to be addressed. The main areas of concern were in the distribution of cash, selection of cash transfer service providers and the reconciliation and monitoring of cash distributions.

Due to the fluidity of physical cash it poses several risks to both beneficiaries and DRC staff. It is therefore more desirable to reduce the use of physical cash to a minimum to help reduce these risks to an acceptable level. Most operations recognise this and have utilised several modalities for cash distributions. Nevertheless, in some contexts the only option is physical cash and therefore it is imperative that appropriate cash handling SOPs exist. It was however found in several operations that cash handling SOPs were not sufficient to address the risks or simply did not exist. There were also examples of SOPs existing but not being complied with by staff.

Where a cash transfer service provider has been utilised to distribute the cash, the process for selecting the service provider was not always fully compliant with donor and DRC requirements. In 2017 a process for selecting cash service providers was developed and implemented. However, the awareness of this process is not wide spread and not consistently complied with. The risk resulting from having a non-compliant process for selecting a service provider is the loss of funding due to a donor disallowing the cost.

Several of the larger cash distribution programs that were covered by the audits lacked reconciliation and monitoring processes that ensures the existence of a full audit trail supporting the cash distributed. In other situations, a reconciliation process existed but was either not always fully completed or was not thorough enough to provide adequate assurance that cash had been distributed to the intended recipient.

2. Thematic audits

Safety and Security Management

Within DRC, safety and security management is referred to as just safety management. This approach assists in ensuring that the management of safety and security threats is not too heavily focused on just security threats. This is further supported by the safety management policies and processes of DRC which were first developed 5-7 years ago and provide guidance and advice to staff on the management of safety in their operations. The policies and processes have been tweaked from time to time but a formal thorough review has not occurred since their initial implementation.

The Global Safety Policy and Safety Risk Management System (SRMS) are the two key documents which detail the minimum requirements that an operation must have in place for safety management and provides guidance and processes to achieve this. The policies are thorough and clear but the risk is in how they are utilised by staff in operations and whether there is sufficient resources and capacity to ensure that the minimum requirements are implemented. A concerted effort must be made by all levels of management to ensure that sufficient resources are made available to enable the necessary safety management capacities and resources to exist in all of DRC's operations. Further the roles and responsibilities of all staff regarding safety management need to be supported by appropriate management reporting lines.

A key part of the safety management strategies is to ensure staff are appropriately prepared for the contexts they are working in. To date the focus to ensure this exists has mainly been on expatriate staff and those traveling to SLS 4 and above locations. However, it was evident that national staff also require trainings to ensure they are best prepared and also staff located in SLS 3 and below locations still need some training relevant to the context. Providing resources to enable staff to receive appropriate training is however a considerable challenge for DRC. Currently the policy that staff traveling to SLS 4 and above locations must have completed HEAT training is not being achieved with a substantial backlog.

A lack of a formal policy on duty of care and documentation clearly defining the roles and responsibilities of DRC and its staff regarding duty of care demonstrates that the organisation needs to recognise the significance of the matter and considerable risk it is exposing itself to. The issue in resolving the matter appears to stem from the cross cutting nature of DRC's duty of care and that responsibility for developing a policy has not been assigned. Management need to address this issue so that a policy can be developed and help to ensure that DRC can and is fully meeting its duty of care obligations.

D. Conclusions

There are many reasons and causes for the existence of the findings identified during the audits conducted. The internal audit function tries to identify these so that effective recommendations to address the findings can be provided. There are however limitations to what is possible given the timeframe and scope of the individual audits. It is recognised that some recommendations may not be the most appropriate given the context and challenges faced by the operations. That said there are reoccurring reasons and causes that are identified and need to be addressed at a holistic level and not in isolation at the individual operation level. These are covered below.

The recognition of misconduct is dependent on a societies perception of what constitutes misconduct which generally stems from the social norms of that society. DRC has clarified and documented what as an organisation they perceive to be misconduct. Traditionally, the recognition of the occurrence of misconduct has focused heavily on the international operations at a country level with little consideration at the regional level and very little at the HQ level. Most notably this is evidenced by management being disinclined to make the Code of Conduct applicable to all staff. Several reasons have been stated for why the Code of Conduct cannot be applied universally but generally they are not justified as most INGOs based in Denmark have universally applied code of conducts.

The recent cases of misconduct involving large international organisations is testament to the need for management to be the advocates of the Code of Conduct and to ensure that the policies and processes are complied with by all. Because of the nature of the Code of Conduct the approach needs to be black and white and should not allow for ambiguous management involvement. The Code of Conduct will only meet its objectives if staff and the stakeholders of DRC have trust in the processes, and this can only be achieved through management leadership.

The differing approach to misconduct has also resulted in an unequal application of policies and processes at the different levels of management. While compliance with and enforcement of them is a main focus at the country level, management do not apply the same focus at the HQ level. The resulting impact is that a culture within the organisation ensuring compliance with the policies can be difficult to harness. Management need to lead by example and be consistent in their approach and not allow for instances of non-compliance because the local context allows for it.

There has been consistent policy development across all functions over the last 5-7 years with several revisions and changes along the way. This is positive as it demonstrates that the organisation recognises it needs to change and adapt to the contexts it operates in, and that complacency can be very risky. There is however some negative impacts of the constant policy development and implementation. The first is that it is difficult for stability in operations to be maintained with staff being required to implement new policies and processes every six months or so. This can result in staff turnover and non-compliance due to confusion over which policies are applicable and when. The constant change also demonstrates that the right capacity and resources to develop the policies in the first instance may not consistently exist.

Management need to recognise the importance of making the right investment at the right time when developing policies and processes. A piecemeal approach can be disruptive to operations and not adaptable and reflective to the needs. Therefore, an appropriate prioritisation of the allocation of resources needs to occur. Prioritising new initiatives over

existing ones that have not been fully implemented, may in the long run render the existing initiatives unsuccessful. The risk management framework is a vital management tool in helping to make these decisions and therefore needs to be fully implemented and supported.

Confusion over roles and responsibilities continues to be an area that requires attention. Many staff across a range of functions interviewed during the audits expressed confusion over their role and responsibilities. This further was evident between the three management levels where a lack of clarity has resulted in different regional structures being developed and the purpose of the region offices being individually defined. Initiatives undertaken in the first half of 2018 to strengthen the role of the region offices will hopefully address some of the findings. This will need to be supported by the provision of resources to meet identified gaps.

Linked to roles and responsibilities is the absence of staff consistently being held accountable for their actions. Over the past couple of years there have been several risks realised that have resulted in considerable losses to DRC. However, to date there has been little evidence that any of the staff involved have been held accountable. It has at times been argued that it was beyond their control to mitigate the impacts to DRC but the evidence too often does not support this argument. What is reinforced however is that in some circumstances the failure of DRC to appropriately support a staff member has resulted in their inability to prevent the negative impacts of a risk being realised.

The flexibility of funding is an issue for operations at all levels. DRC operates with a level of fixed costs which are generally not in correlation to the level of project activity. To fund these costs many country operations are dependent on obtaining donor grants. There is therefore the risk that project activity is not solely influenced by need and strategic direction but from a need to fund fixed costs.

At the region office level this is ever more evident due to the smaller proportion of direct project activity. As a result, the funding of most region offices is mainly from grants at a country level. Unfortunately, though the region offices are an integral part of DRC's structure donors are not overly happy to be funding the region office costs directly.

At the HQ level the issue becomes more apparent in the ability of the organisation to fund new initiatives while ensuring the required development of policies and processes continues. Management need to ensure that the priorities are balanced and that there is a recognition of the costs that donors are willing to fund and those that are considered intrinsically the responsibility of DRC.

While new funding opportunities will need to be explored to address some of the funding needs of DRC, management must also address the existing approaches to the management of funding. The whole ethos regarding budget management in DRC needs a considerable overhaul. The right positions need to be given the mandate and tools to manage the budgets they have responsibility for. Only then can the appropriate decisions be made relating to the prioritisation and allocation of funding.

Over the past few years there has been a strong focus on ensuring compliance with donor requirements and ensuring that donor funds are fully spent. This focus has been driven for several reasons including a need to generate overhead funding and to avoid the possibility of returning funds due to ineligible or unspent funds. While the focus on compliance is important it has had some knock-on effects. Policies and processes have been developed that are operationally cumbersome and not always effectual in mitigating the risks. Further due to the operational issues they can cause, exceptions to the policies have subsequently been

developed. Again, while necessary in some circumstances there is evidence that these have been at times inappropriately used. The other impact is that the focus can be too far on the side of grant management and not on the project implementation and the quality thereof.

Policy development in HQ has traditionally focused on ensuring compliance with donor requirements and determining the position and approach to the sectors and modalities for project/program implementation. The project management policy development has received less attention and operationally it has become evident that there are gaps in the processes for the delivery of project activities. To date it would appear that country operations have been expected to fill these gaps by developing local processes where gaps exist. Unfortunately, besides this being an inefficient approach due to multiple processes being developed instead of one universal process, it has resulted in several losses to the organisation. This has been evident in the monitoring of activities and DRC's ability to provide evidence that what has been reported to donors has occurred. More recently the gap in proper distribution processes has been put in the spotlight with the recent ECHO audit.

The overemphasis on country operations being independent in the implementation of their projects is further supported by a desire to provide them with the freedom and flexibility to manage their programmes as they see best. Interestingly however is that the perceived roles of HQ and region office staff can be prohibitive to support this freedom and flexibility. Nevertheless, this approach limits the possibility of an organisational wide ways of working being embedded in DRC's operations. This is of vital importance in operations that experience high turnover as it can be impossible for existing and remaining staff to get consistent guidance and leadership. It is not being stated that flexibility cannot exist, but it needs to be necessary and managed.

E. Management Response

The management response to the Internal Annual Audit Report (IAAR) is the consolidated response from the DRC Executive Management Team (DRC EMT).

DRC EMT appreciates the findings and recommendations put forward by the Internal Audit team throughout its audit activities and subsequent reports in the reporting year of 2017-2018. DRC EMT further appreciates the generic summary of these findings as they are presented in the IAAR.

As clearly stated in the IAAR, the report does not reflect or list which mitigation measures the organisation has already employed to address the risks identified. Neither does it evaluate the effectiveness, appropriateness and impact of these measures – or provide guidance as to which of the issues the organisation should prioritize to focus on to address the most important global risks. The focus of this management response letter is therefore to present the major risk management initiatives from the side of the organisation, which are already being implemented, and link them to the findings of the report.

Appreciation of consistency

DRC management and specifically the DRC EMT and the DRC Executive Committee are advised by three annual internal reports when assessing and prioritizing the most important non-compliance issues and risks facing the organisation's international operations:¹

1. the Internal Audit Annual Report (IAAR);
2. the Annual Risk Management Report; consolidating the operations identification of risks through risks registers
3. the Code of Conduct Reporting Mechanism (CoCRM)², aggregating the findings from the code of conduct reporting mechanism.

Together the three reports constitute a comprehensive, holistic, and evidence-based input to the decisions and prioritisations of the management, which again are taken into the budgeting process of the organisation in order to ensure resources to support the mitigating of issues and risks identified.

DRC EMT is very pleased to see that there is consistency across the three reports in terms of identifying challenges and weaknesses of the organisation. From a DRC EMT perspective, it illustrates a culture of openness and willingness to engage in identifying the issues we are facing when operating in very complex environments where external factors (i.e. safety, change of national legislation & donor policies) has a tremendous impact on our ability to assist the displaced and their host communities in accordance with our mandate and internal policies and procedures. And where our resources and capacities, as the IAAR rightly points to, are often under pressure.

All three compliance mechanisms and reports were initiated in 2015 and 2016. DRC EMT fully acknowledge that DRC as an organisation is still in the process of implementing and

¹ In addition to the three reports, DRC International Country and Regional Operations are performing compliance self checks on a regular basis and regulates its initiatives to address risks and ensure compliance through the results contract processes.

² Available at the website at: <https://drc.ngo/relief-work/concerns-complaints/code-of-conduct>

consolidating this framework to ensure that the entire organisation make full use of the findings of the reports, develop plans and set aside means to address and/or mitigate the issues and persistently insist on management attention to these areas.

Management response to the Internal Audit Annual Report 2017/18

The Internal Audit Annual Report 2017/18 (IAAR) points towards several areas where further improvement is needed, or where the organisation needs to (re)balance its focus. The three main areas raised in the conclusion are summarised as:

1. **Code of Conduct implementation.** Lack of global coverage of the Code of Conduct, compliance with policies and issues related to management involvement.
2. **Confusion over roles and responsibilities.** Confusion between the three layers of the International operations (HQ, regional offices & country offices), including on budget responsibility, and on ensuring sufficient clarity and funding to sustain the operations.
3. **Policy development and programme implementation.** The focus of the organisation on compliance and policy development and improvement has not been prioritised effectively, has overburdened operations and has sometimes been at the expense of ensuring the quality of project implementation.

The DRC EMT will address these three issues below focusing on initiatives that are currently being implemented and perceived to address them and most of the key findings in the Report.

Subsequently, the DRC EMT will comment on two further issues raised in the findings of the report:

4. **Compliance with Local Laws and Regulations.** Although progress has been made there are still risks related to non-compliance with local laws and regulations.
5. **Supply Chain Management.** The awareness and understanding of the supply chain policies and processes is not consistent.

Code of conduct implementation (#1)

The IAAR 2017/18 points to weaknesses in the implementation of the Code of Conduct. Similarly, the Code of Conduct Annual Reports for 2016 and 2017³ clearly identifies challenges and priorities for the organisation in terms of enhancing and strengthening its prevention, detection and response mechanisms in relation to serious misconduct. The Code of Conduct workplan for 2018 sets out priorities and direction for addressing the issues identified and work is progressing as planned. Additional resources have been allocated in 2017 and 2018 to the Code of Conduct team in HQ to manage both an increasing intake of complaints as well as to address the priority issues and challenges. For details on how the organisation is addressing the findings related to the Code of Conduct please refer to the CoCARs and the Workplan for 2018.

Related to the issues raised in the IAAR regarding lack of global coverage of the Code of Conduct it was already in March 2018 decided by the EMT to globalise the Code of Conduct, including a complaints procedure. A process and timeline for this was shared with all senior managers in the whole of DRC at the Directors Forum in June 2018 and subsequently discussed

³ Available at the DRC website: <https://drc.ngo/relief-work/concerns-complaints/code-of-conduct>

at the international senior management's Annual Conference, where the code of conduct also featured as a key topic on the agenda, focusing on enhancing the "tone from the top".

In relation to the comment in the IAAR on ambiguous management involvement, the opinion of the DRC Management that the code of conduct reporting mechanism clearly defines due diligence in terms of the independence of the investigations including the role of management, so it is more about rolling out the understanding of CoCRM. The full disclosure of the Code of Conduct Annual Reports on the DRC website in May 2018 was done to increase transparency but also to strengthen the internal awareness and commitment to the Code of Conduct at all levels in the organisation. DRC Management considers the Code of Conduct and the reporting mechanism a crucial component in the ability of the organisation to live up to its values and norms, including duty of care for its staff and ensuring wider accountability and safeguarding aspects. Collaboration between Code of Conduct staff and DRC Management at all levels of the organisation is vital for the organisation.

Finally, DRC Management fully acknowledge that Code of Conduct initiatives have been mainly focusing on the internal application. Under the 2020 Strategy for DRC International Department a separate strategic project is being launched related to increased beneficiary involvement. Accountability towards people of concern is a core commitment of DRC, and part of DRCs CHS certification, and the project 2.1 of the strategic plan is capturing this through a project collaboration between the global Code of Conduct, Protection and Monitoring, Evaluation & Learning teams of DRC.

Confusion over roles and responsibilities (#2)

The most significant initiative to ensure compliance and address issues and mitigate risks that has been initiated over the past years is the decision in 2016 to implement (for the first time ever) an ERP System; **DRC Dynamics**; focusing on streamlining and digitalizing work processes within HR; Finance; Supply Chain and Grants Management. The first modules have been launched and the go-live date for the entire system in all countries is the 1st of January 2019. This includes clarification of authorization levels and assignment of budget responsibilities throughout the entire organisation.

The DRC Dynamics will provide DRC with the much needed "license to operate" in a more and more complex operational environment with increasing demands, and a very high turnover. DRC Dynamics will for the first time ever allow DRC International operations with the possibility to get a system-based master budget which will increase the capacity throughout the organisation to allocate the right level of costs, including support costs (ref. to findings related to Finance Management).

DRC Dynamics will increase transparency and improve quality in the budgets by creating a link between incurred costs, project budgets and budget forecasts. This will help transfer the ownership for implementing within the budget from (in some places) Finance functions to operational management. As part of the implementation process it has also been clearly defined who should be the budget holder and the role will be assigned to the operational management through the system.

As a precondition for the implementation of DRC Dynamics, but also with a view to create a standardised organisational structure in the International Operation, DRC is implementing

Mercer's International Position Evaluation (IPE), which eventually will ensure that all our employees have a much better understanding of management lines and accountabilities including budget management accountability. The IPE is in the process of being implemented throughout the organisation, but the impact of the process is perceived to be most substantial on the international part.

Moreover, in 2017 with a view to ensure the best platform for implementing the 2020 Strategy for DRC International, DRC Management started the process of implementing a **new organisational design**. The International Department was adjusted, and all country operations were organised within a regional structure. The 3rd dimension is a full rethink of how the International Organisation should be organised among others with a focus on defining accountabilities and responsibilities at the three levels with a common vision.⁴ This will address issues of clarity and streamline the regional structures.

DRC EMT believes that together the implementation of DRC Dynamics, the International Position Evaluation and the New Organisational Design will address several of the main conclusions and key findings in the audit report, most notably by assigning accountabilities at all levels, including budget responsibility.

Policy development and programme implementation (#3)

While DRC EMT acknowledge the concern raised in the IAAR related to the many policy developments (#4), the wording related to constant policy development and implementation could signal a non-prioritized and random approach to this, which is not the case. DRC has worked consistently since 2012 to bring up the level of policy, systems and tools to support the field – simply because the organisation was not geared to handle the growth encountered. And this is being done through several comprehensive and planned processes such as Revision of the Operations Handbooks, the implementation of DRC Dynamics and IPE. It has also been done with the acceptance of and support from our Country and Regional Operations as it is recognised that it is necessary to live up to DRC's internal and external commitments. However, the concern of overload raised by the IAAR is acknowledged and shared by DRC EMT. There is a need to balance "need to have" against "nice to have". The process, including issues related to flexibility, must be clearly and carefully managed.

DRC EMT agrees to findings in the IAAR pointing to weaknesses in programme quality and lack of a global policy for project management and implementation. DRC EMT agrees, that over the past years the organisation has generally focused on developing a compliance, code of conduct and a risk management framework alongside improvements in our HR capacities and initiatives related to DRC Dynamics and have had limited capacity to drive programme quality assurance and programme performance at a global level. To address this weakness, the current strategy 2020 for the International Department deliberately focuses on programme quality and the implementation of DRC's response framework – and one of the recommendations from the

⁴ "DRC's new international organizational design is agile with a high level of standardization allowing us frequently to adjust to changes in the operational context and external demands, while delivering in accordance with our standards and values. DRC has lean workflows and decision-making processes. DRC is cost-efficient. We are an organisation with clear management accountabilities at all levels, and we strive to live our values through a coherent and clearly expressed organizational culture. DRC's specialists are critical to the success of DRC's mission and our organisation clearly defines how specialists and managers relate to one another"

Senior Management Group of DRC International to the DRC EMT is that the organisation needs to prioritise implementing a digitalisation process related to programme performance, similar to what DRC Dynamics is addressing in relation to operational performance. The first steps in this direction has been taken.

Compliance with Local Laws and Regulations (#4)

The DRC EMT fully recognises the need to continue to pay special attention to local legislative frameworks in the geographical areas where we work, while we – as well as other INGOs – increasingly are exposed to risks related to legal compliance issues globally.

Compliance with local legislative frameworks was identified primo 2017 as a risk area that needs more attention and resources, and consequently a pilot project was initiated by ID's, HR's and Finance's Directors involving cooperation with the State Attorney (Kammeradvokaten Poul Schmidt) and the employment of a full time legal competency in HQ. Further risk management measures will be included in the budgeting process for 2019 and when preparing workplans and priorities for 2019. It is the opinion of the DRC EMT that DRC needs to carefully analyse the level and type of legal in-house capacity needed to manage issues related to legal compliance as these constitute some of the most severe risks for the organisation today.

Supply Chain Management (#5)

The Supply Chain Strategy was promulgated in late 2017 and subsequently led to the establishment of the Supply Chain Unit in the International Department. For 2018, the key task is to prepare the roll out of DRC Dynamics, and to ensure full understanding of and adherence to global policies and processes. A review has commenced to restructure and simplify the policies, so they are fit for purpose and do not unnecessarily constrict the operations, including a review of the use of derogations. For 2019, the strategy calls for people development and knowledge management thus addressing major concerns of the report.

DRC Dynamics will facilitate a better warehouse operation, including heightened visibility. Through DRC Dynamics, International and Danish Supply Chain operations will be interlinked, with business ownership currently vested in the International Department.

Following the ECHO audit, an Operations Handbook for Distributions is being developed to ensure that adequate documentation is captured and is readily available.

Close cooperation exists between Supply Chain and Cash programming at HQ level to enhance compliance with the governance scheme and available tools, including ongoing development of global framework agreements.

On behalf of the DRC Executive Management Team

Christian Friis Bach
Secretary General
6th of August 2018