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ANNUAL REPORT OF THE ADMINISTRATION FOR 1996  
AND RELATED MATTERS

Addendum

INTERNAL AUDIT AND OVERSIGHT ACTIVITIES

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## I. INTRODUCTION

1. The Administrator is pleased to provide the Executive Board with the first annual report on internal audit and oversight services provided by the Division for Audit and Management Review (DAMR) for the year ended 31 December 1996. The report is submitted pursuant to the arrangements agreed upon at the second regular session 1996.

2. In addition to UNDP, DAMR also provides internal audit and oversight services to the United Nations Office for Project Services (UNOPS) and to the United Nations Population Fund (UNFPA). Sections of the report apply equally to all three organizations i.e., those concerning internal audit, oversight and accountability; organization and resources; and quality service initiatives. However, detailed discussion of the audit and oversight activities carried out on behalf of UNFPA are included in a separate report, which is being submitted by the Executive Director, UNFPA.

## II. INTERNAL AUDIT, OVERSIGHT AND ACCOUNTABILITY

3. Oversight functions as a whole, and internal audit in particular, have undergone significant changes in recent years. It has generally been accepted that designing a few internal controls in an organization to ensure non-recurrence of past problems can no longer ensure its accountability and strategic development, especially in a changing environment. A proactive and preventive approach, one that identifies risks, anticipates problems, and promotes a working environment in which internal control systems encourage creativity and responsible risk-taking, needs to be ingrained. Such an approach, in tandem with conventional audit responsibilities and with due respect to audit independence, contributes to a vigorous accountability culture.

4. The Administrator is fully committed to establishing such a culture of accountability in the organization to ensure that UNDP business is carried out economically, efficiently and effectively. The Administrator wishes furthermore through such a culture to ensure that managers apply and conscientiously follow best management standards and that staff at all levels are held accountable for their performance and resource utilization.

5. In order to nurture and achieve a new level of accountability, UNDP, as discussed in document DP/1996/35, proposed a new accountability framework, supported by the Executive Board in its decision 96/36. As the Board may recall, the new accountability framework involves the following four elements: UNDP mandate, its mission and its goals; shared values; capabilities; and monitoring and learning. The process being used to implement the foregoing throughout UNDP is a technique known as control self-assessment. DAMR has been assigned responsibility for coordinating the implementation and oversight of the accountability framework.

6. In addition, the Administrator has established a Management Review and Oversight Committee (MROC) for UNDP. Chaired by the Associate Administrator, its membership includes the Under-Secretary-General of the Office for Internal

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Oversight Services (OIOS) and senior UNDP managers. The Committee provides advice and oversight on internal audit, investigations, evaluation and other matters relating to accountability. DAMR acts as secretariat for the Committee. Board members may wish to note that the Under-Secretary-General, OIOS, has suggested this type of committee as a model for the other, large independent funds and programmes of the United Nations.

7. The Administrator is pleased to advise the Executive Board that the audit and oversight activities of DAMR during the year have contributed to a heightened awareness of internal control frameworks and improved practices.

### III. ORGANIZATION AND RESOURCES

8. DAMR comprises the office of the Director and five sections: Internal Audit Services (IAS); Management Review and Analysis Services (MRAS); National Execution Services; UNOPS Audit Services; and UNFPA Audit Services. At 31 December, DAMR had 41 authorized posts. The authorized posts for the Internal Audit Services Section include four National Officer positions, located at the two regional service centres.

9. In addition to internal staff resources, DAMR contracted with two international public accounting firms to conduct audits of country office operations in the Africa and the Asia Pacific regions.

10. The Director, DAMR, is concerned that the authorized level of resources are not sufficient to meet his current audit and oversight responsibilities within acceptable professional standards of an average cycle of once every five to seven years. The Administrator shares this concern and plans to address the issue in the budget submission for the next biennium.

### IV. QUALITY SERVICE INITIATIVES

11. In order to enhance the quality of its services and practices, DAMR embarked on a programme of quality service initiatives (QSI) during the year. Through the QSI exercise, which stresses client and stakeholder satisfaction and employee involvement and innovation, DAMR seeks to become: (a) for clients, an instrument of learning as well as control and oversight; and (b) for stakeholders, an instrument for improved performance and accountability.

12. Eleven working groups were established, representing a cross-section of all DAMR staff, to focus on a wide range of issues, including: client service standards; reporting practices; audit methodologies; planning and management processes for audit assignments; core competency requirements; training and development needs; benchmarking; work methods and practices; technology; and records retention.

13. Some of these initiatives have already led to improved practices and results and some will be reflected in the budget submission for the next biennium. Others will be ongoing, as part of a process of continuous self-improvement.

V. INTERNAL AUDIT AND OVERSIGHT SERVICES

A. General

14. The information in the table below summarizes the output of DAMR for the year. Overall, DAMR issued 209 reports during the year and reduced its work in process by 26 per cent.

Audit and oversight services provided in 1996

	In process 01/01/1996	Projects initiated	Reports issued	In process 31/12/1996
UNDP Internal Audit Services	57	70	91	36
National Execution Audit Services	4	12	11	5
UNOPS Audit Services	3	33	31	5
UNFPA Audit Services	48	55	70	33
Special Audits/Investigations	<u>2</u>	<u>9</u>	<u>6</u>	<u>5</u>
	114	179	209	84

15. To meet the challenges posed by the new requirements, DAMR gave special attention to staff development. In accordance with the DAMR 1996 Staff Development Plan and in cooperation with the Office of Human Resources (OHR), 19 staff members attended 16 courses and/or workshops organized by the American Management Association, the Institute of Internal Audit and OHR. Of the courses and workshops, 10 were audit-related, 3 were administrative courses, and 3 were on improving interpersonal and writing skills. Through the QSI exercise, numerous professional meetings were held within DAMR to review a variety of subjects.

16. Part of the function of the Management Review and Analysis Section has been to coordinate the production of UNDP manuals. In accordance with recommendations made by the United Nations Board of Auditors, DAMR completed negotiations to transfer this responsibility to the secretariat of the Programme Management Oversight Committee early in 1997.

B. Internal audits

17. During 1996, DAMR provided internal audit services to 70 country offices and issued 91 internal audit reports, which contained 2,011 recommendations. This is compared to the issuance of 48 audit reports which contained 1,402 recommendations in 1995. Of these recommendations, 1,663 (83 per cent) were accepted by auditees and have been or are being implemented. DAMR is following up on the remaining 348 (17 per cent) recommendations. The distribution of recommendations by function are as follows:

Organizations and financial operations	390
Programme matters	299
General administration	611
Personnel administration	462
Office automation	<u>249</u>
Total	<u>2 011</u>

18. Internal audits identified the following issues, which have organization-wide implications.

1. Organization and financial operations

19. Relationship between resident coordinators and UNIC Directors. There is an issue arising from the unclear relationship between resident representatives and UNIC Directors. Although the recent strengthening of the resident coordinator system should have resolved the issue, it still remains in some countries. In this connection, the Secretary-General announced in his letter of 17 March 1997 to the President of the General Assembly that the process of integrating those United Nations information centres serving developing countries into the Resident Coordinator's Office will be completed.

20. Functions relating to resident coordination, resource mobilization, advocacy, and programme monitoring and evaluation. The division of a country office into the Programme Section and the Administration/Finance Section remains valid. However, adjustments may be required in order to cover emerging functions and functions that need to be strengthened according to the changed priorities and environment in UNDP. Many country offices have realized the importance of this but are facing difficulties in doing so adequately because of the downsizing of their staff. While DAMR does not recommend assigning additional staff, it considers that headquarters guidance and inputs may help resident representatives, within their delegated authority, to achieve an optimum country office organizational structure. Revisions to programming guidelines are under way and should address this issue.

21. Programme support units (PSUs). These were established in response to the need for monitoring and managing programme resources assigned to projects executed by agencies. The growing national execution programme and the consequent increased involvement of the finance sections of the country offices has meant that some of the functions currently undertaken by PSUs are less efficient and/or duplicated by the finance sections. Necessary structural changes coupled with the application of the Financial Information Management (FIM) system should minimize duplications.

22. Certifying and approving functions. It was evident that not all staff members exercising the functions had a clear understanding of their responsibilities, particularly the certifying function. Hence, transactions were certified by staff members who had no authority over or only little knowledge of those activities (either because of lack of staff or lack of clarity). The Division of Finance (DOF) and DAMR are in the process of

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reviewing the functions with a view to clarifying the respective responsibilities of certifying and approving officers and streamlining the process, without jeopardizing accountability.

23. Financial internal controls. The Finance Manual requires that payments made by country offices for non-UNDP funded activities and which exceed \$10,000 a month be based on authorization from headquarters. However, country offices have still not been able to keep track of and control, through the Automated Field Office Accounting System (AFOAS), amounts authorized and payments made. As a result, the payments and authorizations were manually recorded, which did not meet the purpose of the internal control since it depended largely on the knowledge and accountability of the staff members involved. DOF will address this issue with input from the Division for Administrative and Information Services (OAIS).

24. Safeguarding replenishment and transfer of large amounts of cash at country offices. A few country offices kept large amounts of cash on hand because of the absence of a local banking system. Rules and measures to safeguard their replenishment and transfer should be established and strengthened. DOF and DAMR are following up on this matter.

25. Financial contingencies in operating cooperatives/commissaries. There is a need for headquarters to keep track of the cooperatives and commissaries operating in the field and to ensure that they are properly established and do not result in financial contingencies and commitments for UNDP. Management agrees and will follow up.

## 2. Programme matters

26. Programme resources management. There are two systems used in country offices: the Field Office Programme and Projects Manual (mainly for programme resources management) and AFOAS (which was designed to account for country office financial transactions, including expenditures under national execution programmes). They are not currently linked to each other. As a result, duplicate work between PSU and the Finance Section occurred, as noted in paragraph 21. In addition, it was noted that there was a need to improve the monitoring of programme/project expenditures. FIM should serve the purpose.

27. Management of cost-sharing contributions. The current corporate policy in this regard, as specified both in the Finance Manual and the Programme and Project Manual (PPM) is that cost-sharing contributions should be paid in advance of the implementation of planned activities. However, some country offices had incurred expenditures before the cost-sharing funds were actually received; the amounts involved were significant. Two issues were identified: lack of compliance with the policy due to various reasons; and lack of internal controls in the existing management information systems (such as the issue discussed in para. 23). It is expected that the latter issue could be resolved with the application of FIM. As regards the first issue the Bureau for Finance and Administration (BFA) has initiated a policy review, particularly regarding the calculated risk UNDP has to or can bear vis-à-vis its impact, which may

promote the overall programme delivery. Outcome of the review will be used as the basis for a new policy, as appropriate.

28. Programme Logistical Support Projects (PSLPs). It is noted that PSLPs covered activities beyond those specified in the PPM. Management agrees that core activities should certainly not be covered by PSLPs and that necessary revisions to the PPM chapter concerned will be considered.

### 3. General administration

29. General Administration Manual (GAM). With continuing emphasis on decentralization, DAMR considers that more flexibility should be given to country offices in formulating specific procedures according to local situations, based on the policies decided upon by headquarters or the Executive Board. In this connection, the Manual of Operations Management (MOM) is being formulated.

30. Control of official vehicles. Policies, rules and procedures in GAM in this regard were not strictly adhered to or were implemented in various ways by country offices. The reasons for the non-compliance include: time spent and costs involved in complying with the rules; and procedures not considered compatible with the value added by these control measures. With the increased emphasis on decentralization and delegation of authority to country offices, there is a need to review the existing policies, rules and procedures and to determine whether it is best to establish one standard set of corporate rules and procedures or whether flexibility should be given to country offices to establish rules and procedures suitable to peculiar circumstances in the country and submit them for approval by headquarters. This is being addressed in MOM.

31. Inventory control and management. Headquarters and the country offices maintain a large inventory of assets with a significant value. The current corporate policy and procedure require headquarters units and country offices to take inventory and submit it to DAIS annually. However, it was noted that many items were not included in the inventory even though software - FOINVENT - was developed to facilitate the work. Management agrees with DAMR that it is important to review existing policies and procedures to ensure acceptable physical inventory-taking and management and will work with DAMR to ensure compliance.

32. Medical insurance plan (MIP). DAMR repeatedly identified in country offices cases where reasonable and customary limitations for charges, some of which involved considerable amounts, were not always well defined nor was the supporting documentation submitted according to requirements as specified in the Personnel Manual. OHR may wish to further review the situation and improve the internal controls.

### 4. Personnel administration

33. Special service agreement (SSA). Notwithstanding OHR circulars, the use of SSAs in country offices was still not in line with the established rules and

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procedures. The reform of employment contracts shortly to be announced will resolve this situation.

34. Investigation. DAMR noted that the management of some country offices was not clear on how investigations should be conducted in cases where staff members were engaged in unsatisfactory conduct. Therefore, it is important to have clear guidelines on who should be involved in investigations and how and when. OHR has recently issued a revision of the circular concerning accountability, disciplinary measures and procedures, which will serve this purpose and will also ensure that the rights of all concerned are respected.

#### 5. Office automation

35. Approval process of country office automation plan. Some country office automation budgets were not decided on until their automation plans were officially approved by DAIS. Since it took a long time to approve the automation plans, because of various reasons, country offices found that they did not have allocated funds to pay for even routine expenses. DAIS and the Division of Finance (DOF) have reviewed the situation and a circular is about to be issued to advise country offices that the Budget Section will, as a matter of routine, issue an automation allotment to country offices. The allotment will cover basic maintenance and replacement. Any substantial upgrading and/or improvement of office automation will be dealt with separately. In the latter case, country offices will have to make their requests for additional budgets to the Budget Section through DAIS.

36. Disaster and recovery planning. Some country offices did not have disaster and recovery plans, although relevant policies have been established (in the office automation guidelines). However, there appeared to be underlying obstacles to implementing the policies. Headquarters units concerned will review the obstacles and provide necessary assistance to country offices in preparing disaster and recovery plans.

#### C. Management advice

37. With the change process under way in UNDP and following a proactive and preventive approach, DAMR increased its advisory services substantially to assist the review of systems under development and with due regard for emerging policies. Some of these advisory services were solicited by the units responsible for the action, others were initiated by DAMR based on recommendations made in prior internal audits.

38. Although they had an impact on the overall allocation of resources in DAMR, the advisory services contributed to the new systems and emerging policies which would in turn have ensured a comprehensive and sound internal control framework from the outset. Hence, DAMR considers that provision of such services is a very worthwhile exercise that helps to avoid internal control problems and contributes to risk mitigation. This will continue to be a DAMR priority in 1997.



39. The following are some of the DAMR advisory services that contributed to assessments of the internal control framework: participation in the Integrated Programme Management and in the Programme Management Oversight Committee; guidance on best practices to apply in situations where the use of large amounts of cash is required (i.e., in the absence of banking infrastructure); advice to senior management on the process required to bring to conclusion the operations of a cooperative that was established in a country office to facilitate staff access to basic necessities; critical analysis on the draft procedures for recruitment and monitoring of individuals employed under special service agreements; retention of office space by a country office where special circumstances warranted detailed analysis by DAMR before final arrangements were made about the space; review of audit requirements for undertakings financed by specific donors and carried out by UNDP; risk assessment in the context of private sector interaction with UNDP; potential issues for UNDP to take into account in anticipation of significant collaboration with civil society organizations; and disciplinary process in anticipation of a revised information circular on the subject.

40. Similar to the services noted above, DAMR also performed important functions whose objective was the improvement of accountability awareness and practice in UNDP. The scope of these advisory services was wide and included advice on internal control frameworks provided to resident representatives and to groups of managers (such as deputy resident representatives and operations managers).

41. DAMR also participated in task forces that contributed to increased accountability and performance. DAMR continues to participate in a key task force led by BFA on the review of basic internal control applications throughout UNDP, with emphasis on the certifying officer and approving officer functions.

42. DAMR participated in the development of information systems, notably that of the Financial Information Management System and the Electronic Document Management System. DAMR worked with the project team to review internal controls, security and audit trails and communicated the results of the analysis of internal controls directly to the project team members for incorporation into the project design.

43. DAMR also assigned auditors to review other systems in development that required an analysis of internal controls and security. Some of these assignments included the Data Transfer Facility between UNDP and UNFPA, salary advances to be undertaken by OHR and the assessment of sending financial authorizations through electronic mail.

#### D. National execution

44. UNDP Financial Regulation 17.2 requires Governments to submit audited financial reports for nationally executed projects and programmes. The function of the National Execution Section of DAMR is to administer and monitor the audit process.

45. DAMR has been collaborating closely with the Board of Auditors on the establishment of measures that would allow removal of the qualification of the national execution audited expenditure.

46. Since 1990, and in consultation with country offices, DAMR has been producing national execution audit plans in line with revised Financial Regulation 17.2, which requires that each project be audited at least once in its lifetime. (Hitherto the regulation called for the audit of each project annually.) For the 1996 audit (carried out in 1997) and in consultation with the United Nations Board of Auditors, an effort will be made to identify large projects with a certain expenditure level, bearing in mind the once-in-a-lifetime concept, which would provide for receipt of at least 65 per cent of audited expenditure coverage by 15 June 1997.

47. In consultation with the United Nations Board of Auditors DAMR has been increasing its review of the quality of audit reports. For 1989-1992, most of the audit reports provided only certification of the national execution projects financial statements by the auditors, notwithstanding the UNDP requirement for more comprehensive comments, observations and opinions on the various scopes for each project audited. The situation has been greatly improved and more than 60 per cent of the submissions now received are full audit reports with comments, observations and opinions; nevertheless, DAMR is expanding its efforts in this area.

48. During 1996, a total of 42 Letters of Evaluation were prepared as a result of DAMR review of audit reports submitted: 8 pertained to the 1994 audit and 34 to the 1995 audit reports. The remaining 36 Evaluation Letters were transmitted to country offices in February 1997.

49. DAMR undertook 12 audit missions or reviews in 1996. By year end, 11 reports had been issued. They contain a total of 205 recommendations, including 24 that required action by headquarters units. The responses received to the DAMR audit reports support an acceptance rate of 95 per cent. However, DAMR is unable to attest to the rate of implementation of the recommendations because of resource constraints.

50. The major issues that arose from the national execution audit missions undertaken by DAMR in 1996 can be summarized as follows:

(a) Capacity assessment by country offices is not undertaken consistently before engaging in the national execution modality, resulting in an absence of managerial capacity or inappropriate and inefficient project management;

(b) Lack of or unclear instructions on UNDP policies and procedures;

(c) Failure to familiarize all parties concerned at an early stage with the national execution financial accounting system including budget management, monitoring and evaluation procedures and requirements, with resultant errors and omissions;

(d) Delayed delivery by UNDP of year-end financial statements, some of which are dispatched with many errors;

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(e) Failure to transfer UNDP staff expertise to project management and insufficient financial and management oversight by some country offices of project operations;

(f) Implementation of projects by autonomous institutions that are not included in the chain of accountability established by the programme country Governments; and

(g) Calls for simplification and flexibility, including implementation by non-traditional entities such as non-governmental organizations and private-sector institutions.

51. The above issues are being addressed during the ongoing process of revising the guidelines on national execution; DAMR will follow up during future missions.

52. The timeliness of the submission of audit reports by countries remains a major difficulty. Only 11 countries with audited expenditure of \$122.7 million provided their audit reports by the deadline of 30 April 1996. In total, for the financial year ended 1995, DAMR received during 1996 audit reports from 70 countries with audited expenditure of \$405 million out of a total reported expenditure of \$634.8 million. This additional volume of \$405 million was received only after the External Auditors review had concluded.

#### E. United Nations Office for Project Services

53. UNOPS is comprised of 15 main organizational units at headquarters and has five outposted units. The portfolio of active projects and Management Service Agreement (MSA) activities is about 1,800.

54. During 1996, DAMR conducted audits and reviews of both headquarters operations and projects and other activities in the field. This included audits of management and other support services provided by UNDP through UNOPS under Letters of Agreement between the Borrowing Governments and UNDP with respect to activities financed from World Bank loans. This audit was carried out as required by the agreement between the World Bank and UNDP on the MSA audit modality, under which UNDP is to provide the Borrowing Governments with audited financial statements for each MSA with expenditure above \$100,000 during the fiscal year under consideration.

55. At headquarters, a management review of the contractual mechanism known as the appointment for activities of limited duration and a management audit of contracts entered into with consulting firms were performed. Also performed at headquarters was an audit of an indicative planning figure and third-party cost-sharing project in Africa, desk audits of two projects (one MSA activity and the Japanese Procurement Programme) and a preparation of the comprehensive report on MSA activities. Furthermore, the audits of the 20 MSAs were performed at headquarters, with support from audit firms in five of the countries concerned, the services of which were engaged by DAMR for that purpose.

56. Field audits covered the following activities: the project "Technical Support to Procurement" in the Latin America region; the procurement activities of the Programme of Assistance to the Palestinian People, in Jerusalem; the interregional project "Assistance to the Technological Information Pilot System", Phase III; audits of an MSA activity "Japanese Procurement Programme"; the project "Support to Village Groups" and the project "Support for Second Phase PSMP" in Africa; the projects "Logistic Assistance to the Emergency Operation" and "Marine Ecosystems - Red Sea" in the Arab region; and the regional project "Strengthening Multisectoral and Community Responses to the HIV Epidemic in Asia and the Pacific". In addition, six audit communications were issued to UNDP organizational units relating to issues of UNDP concern that emerged in the above audits of UNOPS operations.

57. Because of the special nature and purpose of the audit reports on the audit of the government-funded MSAs financed by the World Bank, those 20 reports do not contain recommendations. The other 10 reports issued in 1996 contained 170 recommendations. Of these, 67 were in the area of finance; 29 in the area of personnel; 40 in administration; 33 in the area of programme; and one general recommendation.

58. UNOPS provided its response on the actions taken or contemplated to be taken to implement the recommendations contained in 7 of the 10 reports. The seven reports contained 120 recommendations, on 107 of which UNOPS agreed (89 per cent of the cases).

59. In reviewing the results from the audit of UNOPS operations, the versatile nature of the UNOPS operations must be borne in mind. Although projects and MSA activities have common aspects, many of them, particularly the larger and more complicated ones, have specific features. Because of limited resources, the audits performed of UNOPS operations in recent years are not of a routine nature from which trends in the operations can be identified. Rather, most items that have been selected for audit have been large projects and other activities constituting stand-alone operations. Therefore, many recommendations are specific to the entities reviewed, and, because of the small number of recommendations, one should refrain from drawing general conclusions.

#### F. Special audits and investigations

60. DAMR devoted over 5,600 staff hours and \$650,000 in contract funds to conduct and coordinate special audits and investigations during the year. The major investigations initiated in 1996 are described below.

61. Reserve for Field Accommodation (RFA). The RFA investigation focused on irregularities in a \$25 million fund established to build office premises and staff housing in countries where such facilities were not available. The Executive Board will recall that this investigation has been reported on in detail on several occasions.

62. Allegations that the senior management of a country office extorted funds from an international consultant. In this instance, the investigation disclosed that the allegations were true and that funds obtained from the consultant were

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subsequently given to government officials as financial incentives. DAMR prepared a final report and supporting documents recommending that disciplinary action be taken against the two UNDP staff members. One resigned after the DAMR report was submitted to the Administrator. The Disciplinary Committee heard the case of the other staff member and is in the process of formulating its decision.

63. Allegations of conflict of interest and collusion between a staff member and parties from which UNDP rented premises. In this instance, the review did not confirm the allegation.

64. In addition, an investigation was made of a staff member who was in a position to have personal loans guaranteed by UNDP in the event of non-payment (a contingent liability for UNDP). In this case, the contingent financial liability was removed from UNDP and the staff member subjected to sanctions.

65. DAMR also designed and is maintaining a database, called the DAMR Investigative Tracking System (DITS), which tracks cases of fraud and mismanagement that are under investigation by different organization units, including OHR, Bureaux, country offices, DOF and DAMR. DAMR initiated this action to respond to the need within the organization to have a centralized repository of information concerning investigations. The database, which was established in mid-1996 and is updated every quarter, presently contains 55 cases. The database is a key tool in the coordination of cases within UNDP.

#### VI. EXECUTIVE BOARD ACTION

66. The Executive Board may wish to:

1. Take note of the present report;
2. Express support for strengthening the internal audit and oversight resources of the United Nations Development Programme.

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