Third regular session 1996  
Item 9 of the provisional agenda  
UNDP

UNDP FINANCIAL, BUDGETARY AND ADMINISTRATIVE MATTERS

ANNUAL REVIEW OF THE FINANCIAL SITUATION, 1995

Report of the Administrator

Reserve for Field Accommodation

Addendum

SUMMARY

The present report provides an update of the activities of the Reserve for Field Accommodation following the issuance of a three-year plan in November 1994. Through a series of management actions, UNDP has revised its strategy for the Reserve as originally presented to the Executive Board in the three-year plan. A decision has been taken to retain housing property originally planned for disposal. The expected contributions from the Joint Consultative Group on Policy partners has been rescheduled to 1997. The costs necessary to complete construction projects begun in 1991 have been higher than estimated. The cumulative effect of these changes has been to raise the level of the Reserve for Field Accommodation at the end of 1995 to $46.8 million (net).

The report outlines in detail the management actions taken during 1995 and 1996, the analysis of contributing factors for the existing situation, and a proposal for the revised accounting treatment for the Reserve for Field Accommodation, which is in line with international accounting standards. The review also identified a number of serious managerial weaknesses which have been or are being addressed. The Administrator is rigorously pursuing the situation and has established a separate management oversight committee to deal with the accountability aspects raised by the review.
I. PURPOSE

1. The present report is submitted pursuant to paragraph 4 of Executive Board decision 95/29, in which the Board requested the Administrator to provide an update on the progress of the three-year plan on the utilization of the Reserve for Field Accommodation (the Reserve).

2. In the third regular session 1995, the Assistant Administrator, Bureau for Finance and Administration, noted that, in view of the overcommitment and overexpenditure in the activities of the Reserve, a series of management actions had been initiated to review its operations in depth. Begun in early 1995, these efforts have been rigorously pursued so that, as a result of the accurate information thereby obtained, improvements are being realized in the management and reporting of the Reserve.

3. During the review, serious issues with regard to the three-year plan as well as management control over expenditure have been identified and are being addressed. These issues caused UNDP to reconsider the assumptions upon which the three-year plan was developed, and subsequently decide not to implement the plan. As a result, the level of the Reserve rose as of the end of 1995. The status of the Reserve is presented in section II; the review of the implementation of the three-year plan in section III; the analysis of the control issues and management action in section IV; the corrective actions taken in section V; and the future of the Reserve in section VI. The proposal of the Administrator is contained in section VII, followed by recommendations for Executive Board action.

4. The report reflects the extensive discussions held with the United Nations Board of Auditors, who have also continued the review of the status of the Reserve. The close working relationship with the Board of Auditors has been characterized by openness and sharing of findings. The results identified through the management actions and investigations undertaken by UNDP formed the basis for the analysis by the Auditors. These, in turn, assisted UNDP in taking further management steps.

II. STATUS OF THE RESERVE

5. At its first regular session 1995, the Executive Board considered the three-year plan for the utilization of the Reserve, prepared in November 1994 on the basis of the financial information as at 31 December 1993. The major element of the three-year plan was the expected reduction of the balance of the Reserve from $41.5 million at 31 December 1993 to below $10 million by 31 December 1996, through the disposal of housing and the receipt of contributions from the Joint Consultative Group on Policy (JCGP) partner agencies.
6. The level of the Reserve, however, increased to $46.8 million as at 31 December 1995 in net terms, as shown in table 1. As is more fully explained below, UNDP decided not to dispose of housing assets and now expects contributions from agencies only in 1997. The non-realization of such income, when coupled with costs required to complete ongoing construction, are the reasons for the increase in the level of the Reserve.

Table 1: Reserve balance

(millions of United States dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CUMULATIVE DISBURSEMENTS a/</td>
<td>28.2</td>
<td>41.5</td>
<td>42.9</td>
<td>46.8 b/</td>
</tr>
</tbody>
</table>

a/ The cumulative disbursements for 1994 and 1995 are net of operating surplus earned on rented housing accommodation.

b/ 1995 cumulative disbursement does not include $5.6 million for invoices received but not paid at 31 December 1995.

III. REVIEW OF THE IMPLEMENTATION OF THE THREE-YEAR PLAN

7. In the three-year plan, UNDP expected to reduce the balance of the Reserve by implementing five elements: completion of construction and purchase costs; disposal of housing assets by sale to third parties; transfer of a share of office premises to partners of the Joint Consultative Group on Policy (JCGP) upon their contribution to construction of offices; generation of surplus rental income over maintenance costs from retained housing; and elimination of the Housing Appliance Rental Scheme (HARS). As is more fully explained in the following subsections, UNDP has not implemented the key elements of the plan, namely, those actions which would result in receipt of revenues, and in addition, UNDP has faced higher-than-anticipated construction costs.

Construction costs

8. All but one of the four construction projects that were in progress in 1994 have now been completed and are in use. The final project is expected to be handed over to UNDP by the end of the third quarter of 1996. UNDP expended $13.7 million for ongoing construction as well as for the purchase of office premises in Haiti during the biennium 1994-1995 and expects to spend $8.0 million in 1996, inclusive of any outstanding amounts to be paid from 1995. These higher-than-estimated costs were the result of such factors as changes to design specifications after construction had begun to accommodate newly identified needs of UNDP and JCGP partners for office premises and delays in construction and subcontracting, associated with undertaking construction in the particular locations.

/...
Disposal of housing

9. As was reported orally to the Executive Board at its third regular session 1995, an international consulting firm was engaged in June 1995 to undertake an evaluation of UNDP housing properties in Africa in order to assist UNDP to determine whether the disposal of housing units was in the best interests of the organization, as was thought at the time the three-year plan was developed in 1994. The findings of the firm indicate that, by and large, it would be more economically advantageous for UNDP to retain the properties. There is also a continuing need for housing units because of the shortage of commercial housing and because of security reasons. In hindsight, it is clear that initial assumptions on the basis of which the three-year plan was developed were unrealistic in that they did not adequately address the needs for the organization or the full financial implications of various options.

10. UNDP now holds 429 housing units. UNDP sold only 3 housing units in one country during the 1994-1995 biennium. UNDP also transferred 124 housing units back to various Governments and has thereby realized large savings in maintenance costs and better operational management. UNDP continues to look for opportunities to dispose of housing properties when it is economically feasible to do so and security or other factors are adequately addressed through commercial housing.

Rental income

11. By the end of 1996, UNDP will have invested $27.3 million in income-generating housing assets. With the tightening of internal controls, rental income from the housing property will exceed the estimates in the three-year plan. It is to be noted that at 31 December 1995, there was already a cumulative surplus of $4.2 million in the operations of the housing area (maintenance costs against rental income). This can be more fully understood from the statement of income and expenditure (annex I to the present report). This trend is expected to continue and its effect is discussed in section VI below.

Agency contributions

12. To date, the contributions of the JCGP partner agencies have not materialized to the level expected. The agencies have thus far contributed $3.6 million, and, in June 1995, UNDP sent a progress report to the agencies and requested further payments of $5.2 million. No additional amounts have yet been received. Discussion is ongoing, both at headquarters and country office levels. Three of the other JCGP partner agencies have now established capital funds for premises and they continue to be committed in principle to sharing the costs. The current agreement UNDP has with the agencies is that the agencies' contributions and their fixed share of equity in the common office premises will be based on the amount of estimated space they will occupy and on the final construction costs. To date, the assets in the Reserve have not been reduced by the agency contributions received, since UNDP will not transfer ownership of any part of an asset until the final accounting is made (foreseen for 1997) and remaining payments are received from agencies. Once this is accomplished, the
assets in the Reserve will decrease by the corresponding amount of the contributions.

13. The other activities under the Reserve, namely the elimination of the Housing Appliance Rental Scheme and operational aspects (maintenance and rehabilitation) are proceeding as planned.

IV. ANALYSIS OF THE CONTROL ISSUES AND MANAGEMENT ACTION

14. With a view to improving the management of the Reserve, a new Deputy Director of the Division for Administrative and Information Services (DAIS), who is also a professional accountant, was appointed in the second quarter of 1995 and took charge of supervising the unit responsible for the activities of the Reserve. An initial review of the operations of the unit identified a number of management and internal control issues that needed to be addressed. Actions taken included the suspension of certification authority that had formerly been exercised by the Chief of the Housing Unit and the undertaking of that function by the Director and Deputy Director of DAIS. A new Chief of the Housing Unit, who is also a professional accountant, was appointed to be responsible for the day-to-day management of the Reserve.

15. An international accounting firm was engaged in August 1995 to assist in the detailed examination of all accounts and all related transactions of the Reserve, including an analysis of the accounting treatment so far applied for the Reserve, and, where appropriate, make recommendations for its improvement. As a result of that work, UNDP has decided to apply an accounting treatment that categorizes expenditure and income differently, based on the belief that it is better suited for the activities under the Reserve. The revised accounting treatment is explained in paragraph 22.

16. UNDP also engaged an architectural firm with extensive international experience in February 1996 to provide an independent certification of the construction projects. As of the time of the present report, two countries - Cape Verde and Guinea-Bissau - in which approximately 40 per cent of the total construction costs have been incurred, have been reviewed and UNDP has received confirmation of the appropriateness of the costs incurred for the end product. The review of the remaining countries is expected to be completed by September 1996. As UNDP receives confirmation for each construction site, it will be in a position to make outstanding payments to contractors.

17. In pursuing the management actions, it became evident that there were a number of serious weaknesses in management and internal controls relating to the activities under the Reserve. These include the non-compliance with financial regulations and rules governing the procurement and payment processes. Based on the review undertaken thus far, it has been determined that:

(a) Payments to the prime contractors exceeded the contract amounts that were approved by the Chief Procurement Officer upon recommendation of the Headquarters Contracts Committee. Any changes in the contracts to reflect the higher payments, however, were made without further recourse to the Contracts Committee, which was required by the financial rule. Other contracts involving
sub-activities for construction were also entered into by UNDP without prior submission to the Contracts Committee. As of 31 December 1995, expenditure and claims totalled $47.2 million against originally approved contracts of $27.9 million. The certifications by the independent architect firm referred to in paragraph 16, however, have thus far confirmed the appropriateness of the costs incurred for the end product;

(b) Based on documentation reviewed to date, contracts were entered into with the supervising architect and stipulated either fixed-sum payments or a percentage of estimated construction-cost payments; however, the architect was paid on a percentage of actual construction costs. UNDP is investigating the circumstances under which these apparent changes to the payment modality were made and the justification for them;

(c) There was no system to establish allotments or obligations for activities under the Reserve. Also, there were deficiencies in the discharge of the certifying and approving functions for the Reserve.

V. CORRECTIVE ACTION TAKEN

18. In addition to the management action taken, UNDP has tightened internal financial controls. Procedures have been established to create obligations to cover all disbursements against the Reserve and the certification and approval functions associated with the Reserve have been revised. New operational procedures were put into place, including the introduction of revised accounting treatment for revenue and expenditure, and a temporary freeze was put on outstanding payments for construction and architect services pending clarification of expenditures. Housing suspense accounts, which had been used at the country offices to handle rental income and maintenance expenditure, were closed and replaced with a different system, whereby income is transferred to headquarters accounts and authority issued in the form of allotments to control maintenance expenditure. Tight control is now exercised over housing occupancy rates and rental income owed to UNDP is sought aggressively.

19. The Division for Audit and Management Review is currently investigating certain payments made under the Reserve, and in particular, transactions relating to the supervising architect. The investigation includes a review of actions taken by staff as well as by contracted parties. The review is expected to continue into the last quarter of 1996.

20. The Administrator is committed to taking timely management action against staff who bear responsibility and accountability for the situation, and to this end, he has established a separate management oversight committee to review the circumstances and make recommendations for his decision.

Revision to accounting treatment of the Reserve

21. From the establishment of the Reserve in 1979 until 1994, the accounting for the Reserve was presented as a net statement of expenditure less income. Table 1 presents the net figures for 1994 and 1995 for purposes of comparison. The table also provides the overall picture of the Reserve with regard to the
financing of activities under the specified limit set by the Executive Board. However, it is now recognized that by following this approach, the lack of presentation of gross expenditure and gross income effectively limited the ability of UNDP to monitor expenditure and income patterns necessary to manage the activities under the Reserve, including the development of the three-year plan. In addition, this accounting approach did not properly account for the fixed assets, which, when completed, could generate income on their own.

22. UNDP has revised the accounting treatment of the Reserve to bring it more in line with international accounting standards, recognizing thereby that the Reserve is more in the nature of a capital fund than of a true reserve. This revised treatment consists of full disclosure of investment in assets (purchase and construction costs), accounting for the gross revenues received from rental income of properties, and the more appropriate categorization of rehabilitation expenditure as an asset rather than as an ongoing maintenance expenditure. The foregoing actions provide greater transparency, reflect the activities under the Reserve more accurately, and aid in better management of the Reserve. As explained in paragraph 23 and in annex II, however, this accounting treatment has the effect of elevating the level of the Reserve.

23. One of the main results of the new accounting treatment has been to identify clearly the actual cost of the UNDP investment in housing and office premises assets. Because the assets are now presented in gross terms in the financial statements, rather than as net of income against those assets, there is a nominal increase in the balance of the Reserve. The balance of the Reserve as at 31 December 1995 is $54.8 million, according to the new accounting treatment, as compared to $46.8 million under the old accounting treatment. Annex II presents the complete balance sheet of assets and liabilities under the new accounting presentation.

VI. FUTURE OF THE RESERVE

24. The assets in the Reserve are expected to rise to $62.8 million, in gross terms, by the end of 1996, owing to remaining construction costs that are to be paid. No further housing disposal is foreseen for 1996, and, as indicated earlier, no agency contribution is expected before 1997. In addition, there will remain approximately $2.8 million in outstanding construction loans to Governments. Once all construction is completed, with a further estimated expenditure of $8.0 million in 1996, UNDP forecasts that it will own housing assets of $27.3 million, including capitalized rehabilitation costs of $5.2 million. There are in addition $32.7 million in assets as office premises.

25. The financing of these assets in the Reserve can be understood through a review of the liability side of the balance sheet (annex II). A key element is the movement of the amount "due to UNDP", which is the amount of money by which the Reserve has exceeded the $25 million authorized level, and, in effect, borrowed from UNDP, since 1992, to finance the construction of the assets. The amount of overexpenditure in the Reserve is the amount due to UNDP, and not the amount of the assets in the Reserve. All surplus of income for housing over maintenance costs reduces the amount due to UNDP.
26. With the assistance of the international accounting firm, UNDP is preparing forecasts of the likely future financial position of the Reserve for the next five years. UNDP considers that the forecast amount of cumulative borrowing from UNDP of $27.5 million in 1996 will be the peak borrowing by the Reserve. Based on the analysis of the international accounting firm, it is anticipated that the amount due to UNDP will decline to $12.2 million by the year 2000, principally from the surplus of rental income as against maintenance costs. In this respect, UNDP anticipates the annual operating surplus to range from $2.0 to $3.8 million. This scenario does not take into account the disposal of assets or receipt of agency contributions. Agency reimbursement and disposal of any of the housing assets will result in a further decline in the amount due to UNDP. As indicated in paragraph 11, UNDP expects the agencies to contribute at least an additional $5.2 million. As indicated in paragraph 9, UNDP is committed to the disposal of housing properties when appropriate and feasible. If and when these combined actions unfold, along with other possible scenarios explained below, they will reduce the balance of the Reserve to under $25 million.

VII. PROPOSAL

27. Realizing the difficulties associated with having many varied activities under one reserve account, and recognizing the benefits from having the housing activities under the Reserve account, thereby facilitating both the management of assets and the management of income and expenditure associated with the assets, the Administrator recommends that the Executive Board consider the following proposal:

(a) Include only housing operations under the Reserve:

No further construction of housing is anticipated. Future expenditure will relate only to the rehabilitation and maintenance of residences. Rental income will more than offset these costs. UNDP will maintain its disposal policy;

(b) Transfer the assets relating to office premises from the Reserve and place them directly on the UNDP Statement of Assets and Liabilities:

UNDP would prefer to segregate from the Reserve the current assets in offices. Furthermore, UNDP would amortize them against the administrative budget over time. UNDP office accommodations, and in particular those shared with JCGP partners, will require special attention, as there will be ongoing decision-making about the need for other such premises in the future. This is an area of growth.

28. The Executive Board will recall that the Reserve, which was established in 1979 at a level of $25 million, was intended for housing only. With the identified need for office accommodation, the use of the Reserve was extended in 1989 for common premises with JCGP partners, but without increasing the level of the Reserve. The Governing Council authorized an overprogramming up to $35 million in 1991. Thus, the proposal in paragraph 27 is in line with the original intent and purpose of a reserve for field accommodation.
29. The Administrator recommends that the Executive Board consider at its first regular session 1997 a detailed proposal for the revised scenario for housing and office premises. This would include projections of the level of the Reserve (housing) and the scenario for office premises under the JCGP, a plan for housing retention or disposal, and projections of agency contribution. In the interim, the Administrator requests the Board to approve the level of the Reserve at $62.8 million, under the new accounting treatment, as at 31 December 1996.

VIII. CONCLUSION

30. UNDP was authorized to utilize the Reserve for office accommodation if and when no other options were available. The Administrator confirms that construction was undertaken in countries with such exceptional circumstances, i.e. least developed countries where either the Government or the private sector did not offer any alternative. By implication, this also meant that construction was carried out in situations where the local infrastructure and support system for building activities was very limited and in many respects non-existent. Construction specialists consulted since have confirmed that the prevailing circumstances posed enormous challenges, and have acknowledged that it is a remarkable achievement that UNDP completed these premises with commensurate quality for the funds expended. Hence, while lapses in the management process occurred, thus far there is evidence that the original purpose for these construction activities was addressed, and UNDP obtained assets that will greatly facilitate its operations in those countries. The ongoing investigation will address the accountability aspects of the activities under the Reserve. Equally important, the results of the investigation will provide lessons learned, and the information will assist UNDP in limiting the scope and extent of future construction work, and enable the timely cooperation with partner organizations. The Administrator is convinced that with the corrective management actions initiated, a recurrence of similar problems will be avoided.

31. The Board of Auditors has welcomed the actions taken by UNDP management over the course of 1995 and 1996 to identify and remedy the situation. The Board has indicated to the Administrator that such support will be reflected in its report for the biennium 1994-1995, which will be submitted to the General Assembly at its fifty-first session, and later to the Executive Board.

IX. EXECUTIVE BOARD ACTION

32. The Executive Board may wish to:

1. Note with continued concern the overcommitment and overexpenditure against the Reserve for Field Accommodation;

2. Note with concern the serious management and control issues identified by UNDP in its review of the Reserve for Field Accommodation;

3. Support the management action taken thus far;
4. Note the revised accounting treatment for the Reserve for Field Accommodation;

5. Approve, in principle, the proposal put forward by the Administrator that the activities under the Reserve for Field Accommodation cover housing premises only and that office premises be handled separately, and to this end, request the Administrator to proceed on such basis and report thereon to the Executive Board at its first session 1997;

6. Approve, as an interim measure and until the Executive Board approves a final proposal from the Administrator on the future of the Reserve as indicated in paragraph 5 of the decision, that the level of the Reserve for Field Accommodation be set at $62.8 million in gross terms by the end of 1996;

7. Request the Administrator to report to the Executive Board on the findings and actions taken with respect to the accountability issues relating to the Reserve for Field Accommodation at the first regular session 1997.
# Annex I

## UNITED NATIONS DEVELOPMENT PROGRAMME

## RESERVE FOR FIELD ACCOMMODATION

Statement of income and expenditure for the years ended 31 December 1994 and 31 December 1995

<table>
<thead>
<tr>
<th></th>
<th>1994</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rental income</td>
<td>4,867,149</td>
<td>4,269,250</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
<td></td>
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</tr>
<tr>
<td>Repairs and maintenance</td>
<td>3,101,387</td>
<td>2,550,903</td>
</tr>
<tr>
<td>Other expenditure</td>
<td>0</td>
<td>95,172</td>
</tr>
<tr>
<td><strong>Total expenditure</strong></td>
<td>3,101,387</td>
<td>2,646,075</td>
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<tr>
<td><strong>Excess of income over expenditure</strong></td>
<td>1,765,762</td>
<td>1,623,175</td>
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<tr>
<td>Operating surplus - Beginning of year</td>
<td>825,302</td>
<td>2,591,064</td>
</tr>
<tr>
<td>Operating surplus - End of year</td>
<td>2,591,064</td>
<td>4,214,239</td>
</tr>
</tbody>
</table>
Annex II

UNITED NATIONS DEVELOPMENT PROGRAMME

RESERVE FOR FIELD ACCOMMODATION

Balance sheets as at 31 December 1994 and 31 December 1995

<table>
<thead>
<tr>
<th></th>
<th>1994</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Properties (housing and offices)</td>
<td>40,509,126</td>
<td>46,452,932</td>
</tr>
<tr>
<td>Capitalized rehabilitation</td>
<td>5,177,218</td>
<td>5,177,218</td>
</tr>
<tr>
<td>Household Appliance Rental Scheme</td>
<td>370,559</td>
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<tr>
<td>Construction loans to Government</td>
<td>3,113,063</td>
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<tr>
<td><strong>Total assets</strong></td>
<td>49,169,966</td>
<td>54,761,852</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Accounts payable</td>
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<td>107,190</td>
</tr>
<tr>
<td>Agency reimbursements for construction</td>
<td>3,650,600</td>
<td>3,650,600</td>
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<tr>
<td>Due to UNDP</td>
<td>17,928,302</td>
<td>21,789,823</td>
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<td><strong>Total liabilities</strong></td>
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<td>25,547,613</td>
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<tr>
<td><strong>Balance</strong></td>
<td>$</td>
<td>$</td>
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<tr>
<td>Authorized reserve</td>
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<td>25,000,000</td>
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<tr>
<td>Operating surplus</td>
<td>2,591,064</td>
<td>4,214,239</td>
</tr>
<tr>
<td><strong>Total liabilities and fund balance</strong></td>
<td>49,169,966</td>
<td>54,761,852</td>
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