BUDGETARY AND FINANCE COMMITTEE
Thirty-fifth session
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Item 10 of the agenda of the Budgetary and Finance Committee

ADOPTION OF THE REPORT OF THE BUDGETARY AND FINANCE COMMITTEE
TO THE GOVERNING COUNCIL

Draft report of the Budgetary and Finance Committee

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Addendum

CHAPTER IV. E. FINANCIAL, BUDGETARY AND ADMINISTRATIVE MATTERS

Audit reports

1. For its consideration of item 9 (e) of the Council's agenda, the Committee had before it document DP/1988/5/Add.1 and DP/1988/5/Add.1/Corr.1, which contained the audited financial statements for the year 1986 of those executing agencies subject to an annual audit, together with the report of their external auditors on those financial statements. The Committee also had before it document DP/1988/5, which contained comments by the Administrator on the observations in the various audit reports and the report relating to the United Nations Development Programme (UNDP) itself. Also made available were copies of General Assembly document A/42/5/Add.1, which contained the audited financial statements of UNDP for the year 1986, together with the report and
recommendations of the United Nations Board of Auditors. The Committee was further provided with copies of General Assembly document A/42/579, containing the report of the Advisory Committee on Administrative and Budgetary Questions (ACABQ) on that audit report.

2. In introducing this item, the Deputy Director of Finance drew attention to the report dealing with the UNDP financial statements. This report had been very extensive in scope and had raised a number of complex issues on which the Council should give guidance. In the view of UNDP, some of the auditors' recommendations went beyond the scope of the Administrator's own authority and would require consultations with UNDP executing agencies, their external auditors and possibly the governing bodies of those agencies. In other cases, UNDP had considered the recommendations inconsistent with established policies and procedures which had been consistently followed in the past, or inconsistent with UNDP Financial Regulations or other decisions of the Governing Council. The auditor's opinion on the financial statements for 1986 had also been qualified. The Administrator was particularly concerned that that could be potentially damaging to the trust and confidence which the organization needed to retain among Governments and the public at large, and was naturally anxious that the grounds for qualifying the audit opinion be removed as quickly as possible. Furthermore, ACABQ and the General Assembly, in its resolution 42/206, had specifically requested that a number of issues arising from the report of the Board of Auditors be specifically addressed by the Governing Council.

3. Emphasizing the importance which the UNDP Administration attached to the valuable work and role of the external auditors, the Deputy Director of Finance explained that, where UNDP had been in agreement with the recommendations of the Board of Auditors and had had the appropriate authority, it had already taken or was taking action to implement the recommendations. However, there had been a number of recommendations with which the Administration had found itself unable to agree.

4. The Deputy Director of Finance then highlighted those issues which were considered most important and on which the specific guidance of the Council was required. Those issues which had attracted a qualified opinion and which affected the executing agencies had been discussed with the agencies at the Consultative Committee on Administrative and Budgetary Questions (CCAQ) which had met in March 1988. Agreement had been reached on the establishment of outstanding obligations at the end of each year in respect of travel. With
regard to unliquidated obligations in respect of the procurement of equipment, the agencies strongly supported the present procedures to recognize the obligation on the issuance of the purchase order rather than on delivery, as advocated by the Board of Auditors. This approach was consistent with procedures applied in their other programmes, whereas the delivery concept would require the introduction of new and costly reporting systems. The Board of Auditors had also indicated that, in order to certify the UNDP financial statements, they must receive the audit clearances from the financial statements of the executing agencies. Furthermore, the Board wished to receive audited financial statements from executing agencies on an annual basis rather than on the present biennial financial period. The Board had also indicated that the audit opinion for 1987 would again be qualified for both these reasons. With regard to the annual audit, UNDP had written to the executing agencies requesting them to consult with their external auditors on the possible reintroduction of annual audits for UNDP activities, indicating additional costs, if any, and the possibility of absorbing these costs.

5. With regard to Government execution, the Administration had already taken steps to remedy the situation (see paras. below). The Administration considered that appropriate action had been taken on the other matters which had been the subject of qualification.

6. The Deputy Director of Finance then turned to those recommendations which were inconsistent with established policies and procedures. The Council was requested to give guidance on the basis for recording income and expenditure for cost-sharing and Government cash counterpart contributions, and trust funds; the operational reserve, the liquidity position, budget implementation, budgetary trends and programme and project management.

Summary of the discussion in the Committee

7. Many members stated that they attached great importance to the reports of the external auditors. These provided an essential tool in evaluating management and the efficiency with which the funds entrusted to UNDP were utilized. One member drew attention to the length of time between the issuance of the audit reports and their review by the Council. Although this permitted the Council to have the benefit of the views of the General Assembly it could delay actions which the Council might wish to take in respect of recommendations made by the external auditors. Members were concerned that the Board of Auditors had found it necessary to qualify their opinion on the financial statements of UNDP for 1986, and that they would do so again in 1987.
Several members expressed satisfaction at the steps UNDP had already taken to correct those factors which were within their authority. The Administrator was encouraged to take action to remove the remaining grounds for qualifications. As regarded the timely submission of audited financial statements and the return to an annual audit, members recognized that co-operation was needed from the executing agencies, their external auditors and, in some cases, their governing bodies. The Administrator was urged to pursue consultations with those concerned to find practical and economical solutions. Some members asked what would be the additional costs. In this regard, one member indicated that he could not agree that UNDP absorb additional costs arising from an annual audit, since the agencies concerned derived benefits from such audits. Two members wondered what would happen if executing agencies could not agree to the reintroduction of annual audits for the UNDP-funded activities.

8. With regard to the auditing and timely submission of audited financial statements for projects executed directly by Governments, one member pointed out that a similar situation was to be found in bilateral aid programmes. This member also indicated that in his country it was acceptable practice in Government accounting to establish commitments on the issuance of purchase orders.

9. Several members supported the Administrator's position with regard to budgetary control. In doing so, some members expressed concern at the rising trend in administrative costs. Constant vigilance was needed to contain such costs and thereby maximize resources available for development. Such control, one member suggested, could be facilitated by clear instructions and improved information and internal financial reporting systems. Another member suggested that costs could be lowered by reductions in meetings and documentation and simplifying procedures.

10. With regard to those observations which appeared to be inconsistent with established policy and procedures, one member pointed out that, as the audit had been very detailed and wide-ranging, it was understandable that some problems were identified which had not been recognized earlier. The Governing Council was not infallible and should be ready to review and remedy any inconsistencies. Another member, while acknowledging the auditors' right to query the validity of decisions of the Council and the Financial Regulations, stated that the Administrator was correct to follow the current directives.
11. Two members stated that, in their opinion, the level of the operational reserve should be governed by decision 85/16 of 29 June 1985, which superseded decision 80/50 of 30 June 1980. A further member considered that the situation was indeed confusing, and that in the light of the overall liquidity of UNDP, a full study should be made on the necessity of retaining the reserve. Another member expressed concern that if the level of the operational reserve was too high it could discourage some donors from increasing their contributions.

12. With regard to the observations on the liquidity position, two members could not agree with the auditors' conclusions that the operational and available cash held on behalf of trust funds could be used to meet various cash needs or fund various activities. One member pointed out that cash held in trust funds was subject to specific contractual arrangements and could be applied for other purposes only with the express agreement of the donor.

13. One member, referring to the observation on reporting on a gross or net basis, stressed the importance of providing the reader of the financial statements with complete and accurate information.

14. One member considered that, with the exception of the reports in respect of the World Bank and the Asian Development Bank, those audit reports received from the executing agencies contained in document DP/1988/5/Add.1, were too short to be meaningful. In future, he wished to see more detailed and informative reports. With regard to the audit opinions for the World Bank and the Asian Development Bank, he sought further clarification on the references to deviations from generally accepted accounting principles.

**Response of the Administration**

15. In response to the comments and questions concerning the timely submission of audit certificates and the return to an annual audit by the executing agencies, the Deputy Director of Finance confirmed that these matters were particularly important. Whilst initial consultations had begun with those agencies concerned, it was expected that the issues could only be resolved with the co-operation of the external auditors and governing bodies of both UNDP and the executing agencies.

16. With regard to the qualification relating to the treatment of income for cost-sharing activities, the Deputy Director of Finance pointed out that the executing agencies supported the current approach adopted by UNDP as being the most prudent.
17. Turning to budget implementation, the Deputy Director of Finance confirmed that the UNDP procedures were based on Governing Council decisions. He recalled that ACABQ had not considered that a compelling case had been made for changing the format of the appropriation resolution.

18. With regard to the qualifications in the opinions of the external auditors of the World Bank and the Asian Development Bank, the Deputy Director of Finance informed the Committee that the external auditors had not indicated where they considered that these agencies had not followed generally accepted accounting principles. However, he believed that the external auditors, who were both commercial auditors, were referring, among other things, to the establishment of unliquidated obligations in respect of travel and the procurement of equipment, where the procedures adopted by UNDP and the executing agencies differed from normal commercial practice. UNDP and the executing agencies had taken a pragmatic and cost-effective approach and had established criteria in consultation with the external auditors. He recalled that one member had confirmed that the approach adopted by UNDP was used in his country.

19. With regard to budgetary trends, the Deputy Assistant Administrator pointed out that it was extremely difficult to make a clear delineation between programme expenditure and programme and administrative support cost. While some administrative costs were clear and could easily be defined the situation became blurred when one turned to the field offices. For some years now, UNDP had adopted a zero-growth budget. The answer, he believed, was to keep a watchful eye over all programme and administrative costs. He pointed out that both ACABQ and the Governing Council kept all personnel costs under close scrutiny.