Thirty-sixth session
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Item 9 (d) of the provisional agenda

FINANCIAL, BUDGETARY AND ADMINISTRATIVE MATTERS

Audit reports

Note by the Administrator

SUMMARY

This document contains the comments of the Administrator concerning the report of the United Nations Board of Auditors on the financial statements of the United Nations Development Programme for the year ending 31 December 1987. In particular, it provides further information on follow-up action taken in response to Governing Council decision 88/49 of 1 July 1988 and General Assembly resolution 43/216 of 21 December 1988.

It also summarizes significant observations of the external auditors of the executing agencies on their 1987 accounts relating to funds allocated to them by the United Nations Development Programme. Document DP/1989/58/Add.1 contains the audited accounts and audit reports of the executing agencies as at 31 December 1987, except those for the World Bank, which are contained in document DP/1989/58/Add.2.
INTRODUCTION

1. In accordance with previous Governing Council decisions, as well as General Assembly resolution 43/216 of 21 December 1988, in section I of this document the Administrator is bringing to the attention of the Council the audit report of UNDP, 1/ the report of the Advisory Committee on Administrative and Budgetary Questions (ACABQ) 2/ thereon, the related comments made in the Fifth Committee of the General Assembly and the resolution adopted by the General Assembly at its forty-third session on financial reports and audited financial statements and reports of the Board of Auditors (General Assembly resolution 43/216).

2. The external audit reports and audited accounts of executing agencies relating to funds allocated to them by the United Nations Development Programme (UNDP) as at 31 December 1987, submitted in accordance with regulation 17.1 of the UNDP Financial Regulations, are contained in the addendum to the present document (DP/1989/58/Add.1), together with a summary of the status of funds submitted by all executing agencies as at 31 December 1987 (except that the audit report in respect of the World Bank is contained in document DP/1989/58/Add.2). Sections II to X of the present document contain the Administrator's comments on significant observations made in the audit reports of those agencies. It should be noted that since 1987 was the second year of the biennial period used by the United Nations system, the audit reports being presented this year include audited financial statements and audit reports in respect of all those organizations.

I. UNITED NATIONS DEVELOPMENT PROGRAMME

3. The Administration provided a detailed written response to all the observations made by the United Nations Board of Auditors in its report 3/ and, as in the previous year, the audit report itself contains extensive quotations from that response.

4. The audit report included numerous findings in the areas of accounts, budget, programme management, the Office for Project Services (OPS), the United Nations Sudano-Sahelian Office (UNSO), the United Nations Capital Development Fund (UNCDF), other trust funds, UNDP field offices and other miscellaneous matters. The auditors qualified their opinion on the UNDP financial statements for 1987 as a result of a number of their findings, some of which were the same as findings which had led them to qualify their opinion on the UNDP accounts for 1986.

5. Owing to the length of the audit report and the extensive response by the Administration which it includes, no attempt will be made in the present document to summarize its contents. This document will, however, highlight those observations which led to a qualification of the audit opinion and other observations which relate to matters of particular concern to the Council and which the Council will no doubt wish to take into account in its future consideration of the subjects concerned. It will also summarize the results of the review of the audit report by the Advisory Committee on Administrative and Budgetary Questions (ACABQ) and the Fifth Committee of the General Assembly, refer to discussions of
matters arising from the audit at the Panel of Auditors and at the Consultative Committee on Administrative Questions (Finance and Budgetary Questions (CCAQ(FB))), and indicate significant actions subsequently taken by the Administration in response to the report.

Report of ACABQ

6. In the course of its report 4/ the Advisory Committee expressed the following views:

(a) With regard to the certification of programme expenditures reported by the executing agencies, the Advisory Committee trusted that further discussions between the parties concerned would lead to an acceptable solution to the problem for UNDP, as well as for the United Nations Population Fund;

(b) In the context of its review of the audit report on the United Nations, it noted that the application of the delivery principle for recording the purchase of equipment carried with it the potential for complicating the established programme budgeting process. In the case of technical co-operation activities, it pointed out that long lead times are often involved and that entering into commitments well in advance of delivery does not necessarily constitute an abuse. In the circumstances, it believed that the status quo ante should be maintained, with strict financial control ensured by the enforcement of existing procedures for the certification of commitments and the monitoring of obligations;

(c) Concerning the question of redeployment of resources from the field to headquarters, it reiterated its view, contained in its report on the 1986 audit report, that "On the basis of the information given to the Advisory Committee regarding the pattern of expenditure, a compelling case has not yet been made to change the appropriation resolution at this time. The Advisory Committee requests the Board to keep this matter under review and to report back to the Advisory Committee and the Governing Council if the situation so warrants (para. 35);"

(d) It also reiterated its view that the question of the proper level of UNDP financial reserves was complex and should be addressed by the Governing Council, which could provide specific guidance on points of substance as well as presentation. It noted that measures adopted by the Council in June 1988, as well as currency developments in 1988, will affect the liquidity position of UNDP in the future.

Discussion in the Fifth Committee

7. Members of the Fifth Committee expressed their appreciation for the reports of the Board of Auditors and of ACABQ. They emphasized the importance they attached to the work of the Board and welcomed the broad scope of the audit reports submitted in respect of 1987.

8. Some suggestions were made for changes in the format and content of the audit reports themselves, in particular that future reports might distinguish more clearly between (a) financial and accounting matters and (b) management issues.

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While noting the concern of UNDP that the audit report fully reflect the Administration's views on the issues raised, it was felt that some streamlining of the information provided would be desirable. Several members supported a proposal that the Board should be represented at meetings of the relevant governing bodies when the audit reports were discussed.

9. In the case of UNDP, the main concern of delegations was the fact that the audit opinion had been qualified for the second year in succession. It was recognized that the main causes of this were structural in nature, but urged that every effort be made, through consultations between UNDP, the executing agencies and their auditors, to resolve the issues involved.

10. Members also expressed concern with, and requested further clarification on, a number of other questions dealt with in the audit report, including in particular the delineation between programme and programme support costs, budgetary control, increases in operating costs and the liquidity position of UNDP.

11. Responding to the debate, the Associate Administrator expressed his appreciation for the important and valuable work performed by the Board. It was clear from the report that there were still some areas in which a genuine difference of opinion existed at the technical level between the auditors and UNDP administration and that some of the issues raised were structural in nature and not entirely within the Administration's competence to resolve. On all other matters, however, UNDP had taken, or was taking, steps to remedy to the greatest extent possible any weaknesses or deficiencies identified by the auditors.

12. With regard to the format of the audit report, the Associate Administrator explained that the main concerns of UNDP were that the summaries of recommendations and findings, taken alone, could give a misleading impression of the facts and that the Administration's views on issues raised should be fully reflected in the report. He agreed that streamlining was desirable whenever possible, but this should not be at the cost of oversimplifying what were often difficult and complex issues.

13. The Associate Administrator then referred to the problem of obtaining audited figures from the executing agencies, on which some progress had been made and which would be discussed further by the Panel of Auditors in November 1988. He also outlined the UNDP position on accounting for unliquidated obligations for equipment and recalled that in June 1988 the Governing Council had requested that the present practice should continue. He went on to provide clarification on the questions of overexpenditure of allotments, the delineation between programme and programme support costs, the liquidity position of UNDP and other specific questions raised during the Committee's discussions.

14. In his response to the debate, the Chairman of the Board of Auditors welcomed the suggestion that a representative of the Board should be present at meetings of the governing bodies when the audit reports are discussed and indicated that the Board agreed to separate its future reports into two parts, one relating to accounting matters and the other to management issues.
15. In connection with the audit report on UNDP, he stated that the current practice for recording unliquidated obligations had not been as yet a basis for qualifying the audit opinion. He also said that significant progress had been made in obtaining audited statements of the executing agencies before the Board issued its opinion on the UNDP accounts but that the main problem remained that of obtaining annual audited statements from those organizations which are audited on a biennial basis. He noted that the resolution of this question might involve additional audit costs in some cases and that the issue should be debated between UNDP, the executing agencies and their external auditors.

General Assembly resolution 43/216

16. Following the discussion of this subject in the Fifth Committee, the General Assembly adopted resolution 43/216 on 21 December 1988. The attention of the Council is drawn, in particular, to the following operative paragraphs of that resolution:

(a) Paragraph 2, which requests the [UNDP Governing Council] to require [the Administrator] to take immediate steps within [his] competence to correct the situations or conditions that gave rise to the qualification of the audit opinion;

(b) Paragraph 3, which urges the panel of external auditors, administrations, governing bodies of the executing agencies, and other relevant parties concerned to solve the problem with regard to the certification of programme expenditures executed and reported by United Nations executing agencies in co-operation with the United Nations Development Programme as well as with the United Nations Population Fund;

(c) Paragraph 5, which requests [the Governing Council] to ensure that [the Administrator] takes the necessary steps on a priority basis to implement the recommendations of the Board of Auditors and the Advisory Committee on Administrative and Budgetary Questions, as contained in their respective reports, and to report thereon to the General Assembly at its forty-fourth session;

(d) Paragraph 6, which requests [the Administrator] to take without delay appropriate measures within [his] competence in light of the comments, observations and recommendations of the Board of Auditors and the Advisory Committee on Administrative and Budgetary Questions, including those relating to financial reporting, budgetary controls, unliquidated obligations, cash management, trust funds, and hiring of consultants, experts and temporary assistance, and to report to the General Assembly at its forty-fourth session, through [the Governing Council];

(e) Paragraph 7, which requests [the Administrator] to submit to the General Assembly at its forty-fourth session, through the Board of Auditors and the Advisory Committee on Administrative and Budgetary Questions, specific measures taken to implement previous recommendations of the Board of Auditors, and also requests the Board and the Advisory Committee to evaluate the efficacy of those measures;
(f) Paragraph 8, which recommends that all future reports of the Board of Auditors continue to include separate sections that summarize recommendations for corrective action to be taken by [UNDP], with an indication of relative urgency;

(g) Paragraph 14, which invites the administration of [UNDP] to review [its] accounting policy with respect to unliquidated obligations taking into account generally accepted accounting principles;

(h) Paragraph 16, which invites Governments that are represented on [the UNDP Governing Council] to ensure that full consideration is given to the reports of the Board of Auditors and the Advisory Committee on Administrative and Budgetary Questions and the comments made thereon by the Fifth Committee;

(i) Paragraph 17, which encourages [the UNDP Governing Council] to invite a representative of the Board of Auditors to be present at [its] meetings when considering the reports of the Board.

17. Paragraphs 8 and 16 of General Assembly resolution ((f) and (h) above) are self-explanatory and do not require further comment by the Administrator. In paragraphs 18 to 55 below, the Administrator provides his comments on each of the remaining paragraphs of General Assembly resolution 43/216, including information on actions which, at the time of writing this document, had been taken in respect of the auditors' observations and recommendations. Information on further follow-up action which may be available by June 1989 will be reported orally to the Council at its thirty-sixth session.

A. General Assembly resolution 43/216, paragraph 2: observations relating to the qualification of the audit opinion

18. The following paragraphs refer to the observations which relate to the qualification of the audit opinion, together with the Administrator's further comments thereon. It should be noted that, in the final preambular paragraph of General Assembly resolution 43/216, the General Assembly recognized that the qualifications on the certification of programme expenditure in the audit opinion on the UNDP accounts were "technical in nature".

Reliance on the external auditors of executing agencies (paras. 60-65 of the audit report)

19. In a letter to the Secretary of CCAQ(FB) in July 1988, the Executive Secretary to the Board of Auditors sought to clarify the position of the Board in relation to this issue prior to the Committee's review of the matter at its session in September 1988. He explained that the external auditors of the executing agencies should be provided with the statements and schedules prepared by the agencies and submitted to UNDP on an annual basis. The external auditors of the agencies would then carry out a limited audit of these documents and communicate the results of such audit to the external auditor of UNDP. He emphasized that this exercise did not imply a comprehensive audit of the entirety of the accounts of the executing agency nor the issuance of an audit opinion on such statements. The modalities and /...
scope of this limited audit would be discussed by the Panel of External Auditors in November 1988, including the possibility that there would not be additional audit fees involved. The Board of Auditors had already agreed that it would not request additional fees for the executing agencies for which they were the external auditors.

20. When considering this matter at its meeting in September 1988, CCAQ(FB) agreed that means of avoiding qualified opinions on UNDP accounts should be found as soon as possible. It believed, however, that the concept of limited audits would have to be more clearly defined, especially as regards scope and timing, before a position could be taken on this proposal, and that the relation between such audits and the audit of other funds, as well as the direct and indirect costs involved, needed to be clarified.

21. As requested by the Governing Council in paragraph 5 of its decision 88/49 of 1 July 1988, and as indicated in paragraph 65 of the Board's report, this issue was considered by the Panel of External Auditors at its session in November 1988. An extract of the report of the Technical Group to the Panel (whose recommendations were accepted by the Panel itself) is attached as an annex to this document. Paragraphs 47 to 52 of the Group's report relate to this issue and paragraph 56 contains the Group's recommendation that "The Board of Auditors continue further consultations with UNDP and the external auditors on ways and means to receive audited accounts on UNDP operations on a timely basis, and on the nature and extent of the audit work required".

22. At the beginning of 1989, the Chairman of the Board of Auditors wrote to the external auditors of the executing agencies with suggestions on the audit procedures to be followed and the information to be provided by them in connection with their audit of UNDP-financed activities for the year ended 31 December 1988. In the case of those organizations with biennial audit procedures, a description of the scope and objective of a "limited audit" was also provided.

23. In March 1989, CCAQ(FB) discussed this question again in the light of the report of the Panel of External Auditors and the letters from the Chairman of the Board to the external auditors of the agencies. The representatives of agencies with annual audit arrangements indicated that they believed it would be possible for audit clearances to be sent to the Board by the date proposed by its Chairman. The representatives of agencies with biennial audit arrangements indicated that they could agree to limited mid-biennium audits of their UNDP-financed activities provided that no significant extra work was involved for their staff and that no additional audit costs would have to be met by them. They considered that if the Governing Council desired such audits, UNDP would have to cover the costs involved. They were also willing to provide UNDP with estimates, prepared in consultation with their auditors, of the additional costs involved.

24. UNDP has since written to all the organizations with biennial auditing procedures and requested them to inform UNDP of the additional costs, direct or indirect, which they consider a limited audit at the end of the first year of a biennium would entail. UNDP also asked to be informed whether in principle such an audit could be carried out without involving any change in their financial

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regulations or any specific action by their governing bodies. The responses received from these agencies will be reported orally to the Council at its thirty-sixth session.

Audit of government-executed projects (para. 66 of the audit report)

25. The difficulties encountered by UNDP in obtaining audited accounts in respect of government-executed projects were discussed extensively by the Council at its regular sessions in 1987 and 1988. By paragraph 9 of decision 88/18 of 1 July 1989 the Council authorized the Administrator to establish a small unit to administer and monitor audit requirements for these projects. A detailed report on government execution of projects, including the impact of revised accounting, reporting and auditing procedures, is due to be provided to the Council in 1990. Meanwhile, an oral report on progress made in obtaining audit certificates for 1988 will be provided at the Council's thirty-sixth session.

Cash-counterpart accounting (para. 70 of the audit report)

26. The auditors found, inter alia, that there was inadequate documentation to support 1987 cash-counterpart expenditures or the balance of unexpended cash-counterpart resources as at 31 December 1987 on a project-by-project basis and that the only documentation available on a project-by-project basis in respect of cash-counterpart contributions, which are paid in local currencies, was expressed in United States dollars and could not be reconciled with figures expressed in local currencies.

Accounting delineation between programme, programme support and operating expenditures (paras. 46-49 of the audit report)

27. As indicated in its responses to previous audit comments on this subject, UNDP believes that it is not always easy to draw a clear dividing line between these three elements of the organization's costs. Opinions can legitimately differ on the most appropriate delineation between the respective cost elements. In view of this, it is most important that all parties understand current practice in this regard, so that there can be no misunderstanding.

28. With this in mind, the Administration included in its revised budget estimates for 1988-1989 (DP/1988/52, sect. I) a detailed explanation of the various funding mechanisms currently used by UNDP to meet the costs of its programme support and administrative services. This presentation was reviewed by ACABQ (DP/1988/58) and by the Budgetary and Finance Committee (BFC) of the Governing Council at its thirty-fifth session in June 1988. The Council took note of this presentation and decided to keep the issue under review in the context of the biennial budget presentation (para. 14 of decision 88/46). At the request of ACABQ, moreover, updated versions of two principal tables, describing respectively the budgetary and extrabudgetary funding mechanisms of UNDP, will now be included in each biennial budget document, and have been included in the 1990-1991 budget estimates (DP/1989/55).
29. Furthermore, as a further response to the concerns expressed, a review is being conducted into existing programme logistical support projects in the field and guidelines have been established with regard to project-funded posts at headquarters.

Disclosure of Government contributions to local office costs (paras. 73-74 of the audit report)

30. In the preparation of the UNDP financial statements for 1988, the total amount of contributions received from Governments towards local office costs, as well as other income credited directly to the biennial budget, have been shown separately in statement I (income and expenditure of the UNDP Account) as recommended by the auditors. It has been shown, however, as a deduction from the gross costs of the UNDP biennial budget as required by UNDP Financial Regulation 4.9, rather than in the income section of that statement.

Interest accounting (para. 76 of the audit report)

31. In the 1988 financial statements, the procedure whereby interest earned on cost-sharing and trust fund balances is first shown as miscellaneous income to the UNDP Account and transferred in the following year to the appropriate source of funds has been fully disclosed in the notes to those statements.

Non-expendable property (paras. 80-81 of the audit report)

32. In the 1988 financial statements, the treatment of expenditure on "work in progress" for construction projects financed by the Reserve for Field Accommodation has been disclosed in the notes to those statements.

Delivery concept for equipment (paras. 52, 71 and 93 of the audit report)

33. Although referred to in the audit opinion, the Board of Auditors has explained that these references should not be construed as qualifications of the audit opinion. Further information on this subject is provided in paragraphs 50 to 54 below.

Overruns on allotments (paras. 103-105 of the audit report)

34. As in 1986, the Board of Auditors observed that in a number of cases, allotments issued by the Budget Section had been overspent and, as a consequence of this, qualified their audit opinion, stating that "transactions were in accordance with the Financial Regulations and legislative authority, except for the disposal of budgetary funds in excess of allotments ...". UNDP had pointed out that allotments, as opposed to appropriations, are an internal mechanism for authorizing and controlling expenditure and that therefore an overexpenditure of an allotment cannot be said to represent a transgression of the Financial Regulations and legislative authority.

35. Following further consultations between UNDP and the Board on this matter, the Board has indicated that in future they would not qualify their audit opinion on these grounds.

...
B. General Assembly resolution 43/216, paragraph 3: certification of programme expenditures reported by executing agencies

36. The subsequent actions taken in this connection by UNDP, the Board of Auditors, the Panel of External Auditors and the administrations of the agencies have been described in paragraphs 19 to 24 above.

C. General Assembly resolution 43/216, paragraphs 5 and 6: action taken by UNDP to implement the recommendations of the Board of Auditors

37. In this section, no attempt will be made to repeat the views and comments of the Administration as reflected in the audit report itself. Many of the observations relate to matters which have been, and continue to be, under review by the Council and some of these are referred to in other documents being submitted to the Council at its present session. Where appropriate, the Council may wish to take into account the views of the auditors in their consideration of these matters in this and future sessions of the Council.

38. The following paragraphs concentrate on providing the Council with additional information on any specific further developments or follow-up actions which have taken place since the time of the audit report.

Cost-sharing and cash-counterpart accounting (paras. 67-69 of the audit report)

39. In paragraph 9 of its decision 88/49, the Governing Council decided that the present basis of recording income and expenditure for cost-sharing and cash-counterpart contributions and for trust funds, should continue, pending consideration of this matter by the Panel of External Auditors.

40. The Panel of External Auditors reviewed this question at its meeting in November 1988. Annex I to this document provides a summary of the discussion of this item by the Technical Group of the Panel (paras. 57-59). The Group found difficulties in seeing the implications of the procedure proposed by the Board without a quantification of the income received under cost-sharing arrangements in relation to the total of other income, and also felt that there could be far deeper implications which should be analysed before a conclusion could be reached. Accordingly, it agreed that the Board should prepare a note on the subject for the purpose of a further review of this item at its meeting in 1989.

Budgetary control (para. 106 of the audit report)

41. Work continues on the general issue of budgetary discipline and control. As regards development of practical tools for budget managers, a budget manual has been prepared and circulated for use by headquarters units; a PC-based budget aid has been prepared and issued to a number of headquarters units to assist them in keeping track of commitments incurred against allotments; training courses were held for certifying officers and follow-up training courses are planned for 1989. In the field, an obligation and a budget module for the field office accounting
system have been defined and will be introduced towards the end of 1989. Plans are also in hand to revise and update the budget chapters of the field office finance manual.

42. None the less, creating the environment for sound budget management and supporting managers to this end continues to be a high priority for the UNDP administration.

Questionable support costs (para. 125 of the audit report)

43. The Administration found it difficult to agree with the auditors' conclusion that the support cost charges made in respect of the interregional projects referred to in their report are "questionable" in nature. Support costs are reimbursed in accordance with, and to the extent authorized by, the Governing Council and, as the auditors themselves point out, it is recognized that actual support costs incurred may well be greater or less than the approved standard rates of reimbursement. In aggregate, as the ex post facto reports to the Council on the use of support income show, actual costs incurred considerably exceed the reimbursements made. Furthermore, the cost of hiring and administering experts and other staff is not significantly changed by their physical location.

Legal status of UNDP (paras. 158-159 of the audit report)

44. Since the time of writing the Administration's response to the audit report, two further countries have signed the Standard Basic Assistance Agreement with UNDP, bringing the total of countries which have signed to 107.

Insufficient redeployment of posts (paras. 162-164 of the audit report)

45. The Governing Council, in its decision 88/46, approved the proposed strengthening package for UNDP operations in Africa, effective in the 1988-1989 biennium. A comprehensive proposal with regard to UNDP staffing more generally is being submitted to the Council in June 1989 in the context of the 1990-1991 biennial budget estimates, contained in document DP/1989/55. The administration has therefore sought to address the concerns expressed by the external auditors in this regard.

Insufficient manning (paras. 165-168 of the audit report)

46. The Administration is also anxious to ensure that field posts are encumbered to the maximum extent possible, consistent with a mobile international civil service. It is also conscious of the dangers of excessive reliance upon Junior Professional Officers for core field office functions, one of the considerations underlying the proposals for increasing core professional staff in 1990-1991. Apart from lending its support to any attempt to improve the terms of service for field personnel, the Administration is undertaking an overall review of the terms of service of national professional officers and is enhancing its induction programme for professional entrants.
Use of international languages (paras. 174-176 of the audit report)

47. In paragraph 175, the Board of Auditors noted that the organization's manuals were not always available in languages other than English. As stated in paragraph 176, the Administration has taken a firm decision to have all its internal manuals available in French and Spanish, in addition to English. While it is true that UNDP has experienced some delays in completing the translation of these manuals, some progress has since been made and the Programme and Projects Manual (PPM) has now been issued in French and Spanish. The remaining manuals have been translated and are now being edited for issuance in the very near future.

D. General Assembly resolution 43/216, paragraph 7: measures taken to implement previous recommendations of the Board of Auditors

48. UNDP will prepare a separate report on this subject for consideration by the Board of Auditors and ACABQ prior to submission to the General Assembly at its forty-fourth session. The previous recommendations of the Board were contained in the report of the Board of Auditors on the UNDP accounts for 1986 5/ and were as follows:

"(a) Accounting principles, procedures and controls should be reviewed along the lines detailed in the report and summarized in the audit opinion in order to improve the accuracy and the informative value of the financial statements;

"(b) Guidelines for project preparation and implementation should be issued and/or updated, and strict compliance by executing bodies and UNDP field offices should be enforced, particularly with a view to preventing increased delivery at the expense of quality or viability;

"(c) 'Core activities' should be broken down according to a more detailed pattern of appropriation lines in the biennial budget submitted to the Governing Council of UNDP for approval, and stricter budgetary discipline should be enforced."

49. It should be noted that paragraph 177 of the 1987 audit report refers to matters dealt with in the 1986 audit report and states that "changes introduced in 1987 to comply with the main recommendations contained in the 1986 report of the Board have been commented on under the appropriate heading in the present report ... further action remains to be taken with respect to electronic data processing, policy and strategy".
E. General Assembly resolution 43/216, paragraph 14: accounting policy with respect to unliquidated obligations

Delivery concept for equipment (paras. 52-55 of the audit report)

Unliquidated obligations against budgetary appropriations (paras. 71-72 of the audit report)

United Nations Capital Development Fund (para. 93 of the audit report)

50. As mentioned in paragraph 33 above, this matter is no longer considered by the Board of Auditors to be grounds for qualifying its audit opinion.

51. Following extensive discussion of this subject at its thirty-fifth session, the Governing Council considered that the existing procedures established by UNDP for the recording of unliquidated obligations for equipment should continue to be applied pending the findings of the Panel of External Auditors of these procedures.

52. The annex to this document contains in paragraphs 53 to 55, a summary of the discussions held by the Technical Group of the Panel on this subject at the Panel's meeting in November 1988. Paragraph 56 contains the Group's recommendation that the Panel of External Auditors carry out a review of the nature and extent of the possible abuses in the recording of unliquidated obligations and report back in 1989.

53. UNDP fully agrees that possible abuse of the existing system is an important issue and welcomes the Group's recommendation to focus on that aspect of the matter. UNDP has noted that the Chairman of the Board of Auditors has suggested to the external auditors steps which they may wish to take in the course of their audit of the 1988 accounts to ascertain whether such abuse has taken place. Any relevant information on the results of these proposals will be reported orally to the Council at its thirty-sixth session.

54. With regard to unliquidated obligations against budgetary appropriations, work has commenced on introducing a new module for the Automated Field Office Accounting System which would provide a listing of unpaid items throughout the year. In headquarters, a series of training sessions for certifying officers was organized in the latter part of 1988 which included instruction on the criteria for establishing obligations and the necessity for periodic review of their continued validity. Further training sessions of this kind will be carried out in 1989.

F. General Assembly resolution 43/216, paragraph 17: representation of the Board of Auditors at meetings of the Governing Council

55. UNDP welcomes this proposal by the General Assembly.
II. UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

56. The external auditors conducted a general review of the policies and procedures for project design, monitoring and evaluation of the United Nations Industrial Development Organization (UNIDO). They examined 54 projects in the Asia and Pacific region, most of which had budgets in excess of $1 million.

57. With regard to project design, the external auditors noted the efforts made by UNIDO and UNDP to improve the project appraisal process. Notably, UNIDO separated the responsibilities for project design and project implementation, and established an independent project appraisal section in 1987. Although UNDP introduced more stringent controls for the project appraisal process in early 1987, the external auditors listed three factors that continued to affect both the timely production of project outputs and substantial increases in project implementation rate: (a) poor project design; (b) delays in installation/commissioning of sophisticated equipment (either because of damage or faulty manufacturing); and (c) delays in recruiting experts and the failure of Governments to provide counterpart staff and inputs. UNDP administration notes with concern the findings of the external auditors, and concurs with their recommendation that we assist UNIDO in its endeavours to prevent recurrence of those factors.

58. With regard to monitoring and evaluation, the external auditors cited some serious shortcomings in the preparation and submission of evaluation reports. They listed, as an example, one country where UNDP conducted tripartite reviews of project performance without UNIDO participation. The external auditors also remarked that reviews were poorly conducted and therefore gave rise to doubts on the part of Governments as to the usefulness of spending indicative planning figure (IPF) resources for evaluations. In this regard, the external auditors strongly recommended that UNDP take adequate steps to ensure that the tripartite reviews are carried out with the full knowledge and participation of all relevant parties. In another example, the external auditors listed some UNDP field offices which had failed to submit project evaluation reports, some of which were due as far back as 1986. In response to queries on those reports, the UNIDO administration explained that in July 1988 all field offices were reminded to comply with project evaluation requirements.

III. INTERNATIONAL LABOUR ORGANISATION

59. As a follow-up to their predecessors' report of the 1985-1986 biennium the external auditors of the International Labour Organisation (ILO) commented on compliance with UNDP project monitoring and evaluation procedures.

60. The auditors remarked that ILO had delegated the responsibility for monitoring and evaluation to its Regional Offices. This experiment will be for a period of one year and ILO headquarters will actively follow up on its progress. The UNDP administration notes with interest the ILO decision, and looks forward to being informed as to the impact of the experiment on programme and project quality.
61. The external auditors noted the steps taken by ILO to develop a database to examine feedback of project evaluations and their use in improving the quality of project planning. They also noted, with concern, that a number of evaluation reports were missing, a fact which undermined the value of the database as an information source. They recommended that ILO take appropriate steps to ensure that evaluation reports are sent to its headquarters. ILO has advised UNDP administration that in 1988 all relevant parties had been requested to submit evaluation reports systematically.

IV. FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS

62. As part of their continuing review of the operational activities of the Food and Agriculture Organization of the United Nations (FAO), the external auditors examined documentation and held discussions relating to 32 UNDP-financed projects being implemented in 20 countries. They also visited 15 of those projects in six countries, covering two UNDP geographical regions. Their review focused on FAO participation in the planning, implementation, monitoring and evaluation of projects funded by UNDP and the progress made by FAO in implementing improvements to the new inventory control system.

63. With regard to project planning the auditors commented on the two distinct phases i.e., project formulation and project appraisal. They noted that, in accordance with the principles of the implementation of new dimensions in technical co-operation FAO Governments are increasingly carrying out responsibilities for project formulation without any technical advice from FAO. They also noted that in cases where those principles were applied, the government staff had little or no experience in project formulation. The external auditors consider that some consultants, FAO staff, and UNDP staff also lack experience in project formulation. FAO, in its attempt to alleviate this problem, has held training courses on project formulation for its own staff and has included government staff in other courses on project planning and design.

64. UNDP administration recognizes that strengthening government capacity to identify, formulate and design projects is a key factor in improving project quality. To this end, workshops in project design have been held in close collaboration with counterpart ministries. Training and briefing sessions have also been conducted by headquarters' units, principally the Central Evaluation Office.

65. In connection with project appraisal, the auditors stated that FAO had not formally indicated its policy and attendant procedures vis-à-vis its role in the appraisal process. This may have affected FAO ability to detect and remedy deficiencies in the formulation process. FAO administration reminded the auditors that responsibility for appraisal rests with UNDP and Governments and that its role is to ensure that UNDP guidelines are being followed and that the proposed project is technically sound. UNDP agrees with the response of FAO. The systematic strengthening of appraisal through stronger decentralized and centralized mechanisms for project review and appraisal has been previously reported to the Council.
66. The external auditors commented on the lack of and/or inadequacy of supporting documentation to substantiate the FAO appraisal process. In this regard, they noted that working papers and other documentation prepared during formulation are not normally available to the appraisal process and there is no requirement for them to be submitted in support of project proposals. This led them to question FAO on the methodology it used to confirm the existence of a clear correlation between project activities, outputs and objectives. FAO administration advised that this correlation was usually clearly outlined in the technical contents of project documents and endorsed by UNDP and Governments in their subsequent approval of those documents. With regard to the inadequacy of substantive evidence, FAO advised that, however brief the documentation, in accordance with its established procedures, final appraisal was always carried out by its Development Department. While UNDP administration concurs with the remarks of FAO, it wishes to state that the appraisal process is being closely monitored as part of the overall efforts of UNDP to improve programme and project quality.

67. The external auditors commented on shortcomings that caused delays in project implementation. The principal one was the problem experienced by Governments in providing their planned inputs. This was also pointed out by FAO administration in their review of field programmes. Others concerned the difficulties experienced by National Project Directors (NPDs) in carrying out their management responsibilities. For instance, during their visits to two Asian countries, the external auditors found that the NPDs were generally unfamiliar with both UNDP and FAO guidelines and/or terminologies and this affected their overall ability to carry out effectively tasks such as procurement. In addition, those NPDs faced language constraints which prohibited them from making adequate use of guidance materials, most of which were written in English.

68. To this end, the external auditors noted that, notwithstanding the absence of policy guidelines on training, UNDP had agreed with FAO to fund part of the training costs for NPDs. They went on to recommend that (a) FAO, in consultation with UNDP, should prepare, *inter alia*, simplified training kits for NPDs in various languages, including local ones; and (b) above all, both FAO and UNDP should make a realistic assessment of Governments' abilities to provide project inputs during the formulation and appraisal stages of projects. UNDP fully supports the recommendation of the auditors. Many UNDP field offices provide training directly to NPDs. As in government execution, however, it is equally important to stress that these briefing manuals be prepared by national experts fully familiar with the local administrative procedures. This will enhance the local adaptability of UNDP rules and procedures.

69. With regard to project monitoring and evaluation, the external auditors noted that new UNDP procedures called for the submission of annual reports instead of two six-monthly reports. However, in addition to the annual report, FAO continued to maintain its requirement for the submission of a simplified six-monthly report. Although additional requirements should be kept to a minimum, UNDP endorses this procedure. The auditors also noted the improvements made by FAO to computerize, *inter alia*, its monitoring process. They recommended, however, that steps be taken to improve the quality of work plans to facilitate effective monitoring of projects at its headquarters.
70. The external auditors also listed some other shortcomings in the FAO evaluation process. For instance, procedures calling for establishment of a task force to co-ordinate the review evaluation data were not always adhered to. In addition, no specific procedures have been established to guide staff in the follow-up of evaluation findings; contrary to FAO guidelines, no formal focal point had been established to ensure feedback on all findings arising from evaluations of field activities. In response, FAO administration indicated that the varied nature of projects did not always justify the creation of a task force and that adequate alternative steps were being taken. In their recommendations, the external auditors indicated that steps should be taken to ensure that improved use is made of evaluation findings.

71. As a follow-up to their report on the previous biennium, the external auditors noted the introduction of specific aspects of the inventory control, notably the improved briefing for project managers and verification checks made by headquarters' staff on field visits. The main proposals had, however, not been fully implemented, the delays being caused by lack of resources and financial constraints.

V. UNITED NATIONS EDUCATIONAL, SCIENTIFIC AND CULTURAL ORGANIZATION

72. The external auditors reported that, as part of their continuing review of the operational activities of the United Nations Educational, Scientific and Cultural Organization (UNESCO), they had carried out a headquarters-based review of procedures established and followed by UNESCO in its administration of UNDP-financed projects. The overall purpose of their review was to assess the efficiency of UNESCO procedures and whether they were consistent with UNDP guidelines. During this review, the external auditors examined data for 18 projects and covered areas such as project formulation, implementation, monitoring and evaluation, and the adequacy of programme support costs paid to UNESCO by UNDP.

73. On the subject of project formulation, the external auditors referred to their previous reports, in which they had stated that project documents were frequently drawn up on the basis of vague and unclear objectives which did not facilitate evaluation. In this regard, they noted that the overall situation had improved and that current UNESCO documents for UNDP projects closely followed UNDP guidelines. In response, the UNESCO administration stated that, while UNESCO fully agreed with the observation on formulation, it should be pointed out that a significant number of project documents are prepared by the Governments themselves with assistance from the UNDP field offices; and that they are also concerned with the issue of vague and unclear objectives. The UNESCO administration also stated, and UNDP concurs, that the new UNDP guidelines on project formulation appear to be leading to an improvement in the overall situation.

74. With regard to project implementation, the external auditors reported that, although UNESCO generally followed UNDP guidelines, there were still some operational problems caused by delays in: (a) recruitment of international personnel; (b) procurement and delivery of equipment; (c) selecting suitably qualified candidates for fellowships; and (d) timely provision of government...
inputs. They noted that no allowance was made for the inexperience of NPDs, who were at times recruited instead of international experts. In addition, some of those NPDs were also unfamiliar with UNESCO and UNDP procedures and guidelines. In conclusion, the external auditors recommended that (a) UNESCO analyse the problems and use the experience gained in future formulation exercises; (b) training programmes for NPDs should be expanded; (c) UNESCO should increase its technical support to those NPDs.

75. In its response, the UNESCO administration stated that the negative impacts of the above-mentioned delays are also of concern to them. With regard to delays in hiring of international experts, the external auditors noted that UNESCO is now taking active steps to advertise for candidates before a project document is finalized. UNESCO administration also stated, inter alia, that at times prospective international candidates withdraw their candidatures on the grounds that emoluments offered by the United Nations system are no longer attractive. They further remarked that a growing number of candidates from developed countries providing technical co-operation assistance earn sometimes more, but at least the equivalent when working for their own Governments. As regards equipment, UNESCO administration stated that, in general, a number of factors contribute to delays in procurement and delivery of equipment to project sites. They cited, inter alia, inadequate specifications; absence of field experts to prepare detailed equipment lists; and difficulties in obtaining users' licences. On the issue of fellowships, they remarked that language proficiency, the lack of sufficient number of counterpart personnel, and inadequate qualifications are the principal impediments. Finally, on Governments' failures to provide inputs, UNESCO administration stated that this shortfall is often made known at tripartite review meetings. They further remarked that, while UNESCO shares the auditors' concerns on that subject, it is widely recognized that it is not possible to predict when and if national inputs will be available, especially in the case of debt-burdened least developed countries. As a result, the revision of a project document is, at times, the only solution available to alleviate this problem.

76. With regard to the problems encountered by NPDs, UNESCO administration explained that the resolution of these problems were the subject of intense consultations with UNDP; and that UNDP sought to alleviate these problems by proposing, as do the auditors, that more intensive backstopping be provided to those projects managed by NPDs. They also reiterated that UNESCO is committed to finding solutions to the above-mentioned problems. On a more positive note, UNESCO administration reported that it had achieved significant savings in using NPDs. For instance in 1987, 57 per cent of all expert man-months were provided by nationals as compared to 14 per cent at the beginning of the decade. This, in turn, resulted in the reported expenditure for 1987 being $8.7 million less than it would have been had UNESCO used 100 per cent "international experts".

77. On project monitoring and evaluation, the external auditors pointed out the following: (a) for the projects examined, reports did not always show progress measured against milestones or performance indicators; (b) the UNESCO project management information system (PMIS) was lacking up-to-date information, which hampered its effectiveness as a management tool; (c) both UNDP and UNESCO are missing an important opportunity to improve the effectiveness of operational...
projects by not providing project managers with information on results of the tripartite reviews. The external auditors recommended that corrective action be taken to rectify those shortcomings.

78. UNESCO administration concurred with the external auditors findings on performance evaluation and explained that the format of the new UNDP project performance and evaluation report obliges evaluators to measure progress against performance indicators. With regard to the PMIS, they indicated that measures have been proposed for improving the promulgation and updating of project data. They also noted the external auditors' comments on tripartite reviews and further remarked that substantive comments by UNESCO on project performance and evaluation reports became a mandatory requirement in August 1987 and that the auditors may have looked at reports that were prepared before that time. As part of its efforts to improve the quality of project evaluation and also ensure that all relevant parties are fully aware of the requirements for the new UNDP procedures, UNESCO held comprehensive training seminars which included, inter alia, concrete case studies on operational activities.

79. In connection with reimbursements of support costs, UNESCO advised the external auditors that the decline in UNDP-financed delivery by UNESCO has not been accompanied by a proportionate reduction of programme support required to implement UNDP projects. The external auditors, while taking note of the remarks of UNESCO, recommended that UNESCO undertake a cost-measurement study to determine whether its work for UNDP is fully covered by support cost receipts. The UNESCO administration concurred with the external auditors' recommendation and advised that it will undertake a comprehensive study in preparation for its role in the consultations in light of Governing Council decision 88/52 of 1 June 1988. UNESCO also noted, with appreciation, the administrative services provided by UNDP field offices which, in their view, should not be underestimated.

VI. INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (WORLD BANK)

80. The audit report of the International Bank for Reconstruction and Development (World Bank) is contained in document DP/1989/58/Add.2. The external auditors reported that they performed a headquarters-based review of six projects administered by the World Bank. The review, covering two regional and four country projects in the Africa region, was to determine compliance with the World Bank's established procedures for project procurement; progress reporting; problem follow-up and expenditure control. The external auditors stated that, overall, the World Bank's procedures were complied with in implementing UNDP-financed projects.

VII. UNIVERSAL POSTAL UNION

81. The external auditors of the Universal Postal Union (UPU) reported that they reviewed project documentation. They concluded that, despite some delays and logistical difficulties which were beyond the control of UPU, the objectives of the projects reviewed were attained.
VIII. INTERNATIONAL TELECOMMUNICATION UNION

82. The external auditors of the International Telecommunication Union (ITU) reported that they examined documentation for selected projects financed by UNDP. The documentation included, inter alia, project progress reports, tripartite review reports, evaluation, and final reports. The principal objective of their review was to assess the level of attainment of project objectives.

83. In summary, the external auditors found that: (a) projects were implemented in accordance with UNDP guidelines; (b) several projects experienced delays in implementation and some of them did not, at the initial stage, achieve the immediate objectives. The external auditors attributed the primary causes of delays to Governments' difficulties in supplying project inputs.

IX. ASIAN DEVELOPMENT BANK

84. The external auditors of the Asian Development Bank (AsDB) noted that expenditures for equipment were based on signed contractual agreements or firm orders. With respect to 1987 activities, all equipment was delivered before the year-end and therefore, even if the delivery concept had been adopted instead of the commitment concept the 1987 financial statements would not have been affected.

X. UNITED NATIONS

85. In the course of its audit of the United Nations, the United Nations Board of Auditors examined, inter alia, accounting practices relating to the recording of unliquidated obligations and the administration of technical co-operation activities carried out by the Department of Technical Co-operation for Development (DTCD). The Board's findings in respect of unliquidated obligations are reflected in paragraphs 67 to 79 of its report to the General Assembly. 9/

Other comments relating to DTCD are reflected in paragraphs 324 to 339. 10/

86. The Board recommended that the United Nations reconsider its criteria for establishing and recording unliquidated obligations for goods and services to make them consistent with the delivery principle and with the requirements of the United Nations Financial Regulation 4.3. With regard to DTCD activities, they recommended, inter alia, that a policy be issued to define clearly when a project is considered to be in the pipeline, active, or operationally or financially complete.

Notes


2/ A/43/674.
Notes (continued)


4/ A/43/674.


8/ Ibid.


10/ Ibid.
Annex

EXTRACT FROM THE REPORT OF THE TECHNICAL GROUP OF THE PANEL OF EXTERNAL AUDITORS AT ITS MEETING IN NOVEMBER 1988

UNDP accounting matters (agenda item 6)

Objectives:

46. To continue discussions on UNDP accounting matters raised at last year's meeting, particularly with respect to:

(a) Further ways and means of speeding up the submissions by executing agencies of the audited accounts on their UNDP operations;

(b) Having external auditors of executing agencies carry out mid-biennium reviews of UNDP operations; and

(c) Obtaining members' views on the appropriateness of the present method of recording unliquidated obligations by UNDP.

Summary of discussion:

47. In carrying out these discussions, the group had been provided with a paper prepared by the member from France setting out his views and suggestions for co-ordination with external auditors during the forthcoming biennium, summaries of recent discussion by CCAQ on these matters, and a letter from the UNDP administration expressing its views.

Timely submission by executing agencies of UNDP accounts:

48. It was noted that as a result of a recommendation from last year's meeting, Panel Members entered into discussions with executing agencies about ways of speeding up the submission of their accounts to UNDP. Mainly as a result of this, about two thirds of the audited accounts were received by UNDP on time, which was a significant improvement on prior years. The Group felt that, for the remaining agencies, initiatives should be taken by UNDP to examine ways of speeding up their submissions.

49. The Group also suggested that the instructions issued by UNDP to executing agencies for the preparation and submission of the accounts be amended to reflect the fact that the audited accounts should be submitted to UNDP before April 30. Also UNDP should require that the Operating Fund statements of executing agencies should disclose fully the accounting policies followed by them.

Mid-biennium reporting:

50. The Group recalled that UNDP financial regulations provide for the submission of annual accounts from executing agencies and also provide that in the case of
agencies reporting on a biennial basis, the accounts in the first year of the biennium may be unaudited. The Group also recalled that in response to questions from the member from France, that they had no problem in providing audit opinions on annual statements, but in those entities with biennial reporting periods, additional audit costs could be involved.

51. The member responsible for the UNDP audit presented suggestions for carrying out limited reviews of the accounts in the first year of the biennium. In his opinion, these reviews would enable him to consider giving an unqualified opinion on the accounts of UNDP. Considerable discussion ensued. Some members expressed concern that the limited nature of these reviews may still preclude the Board from issuing an unqualified opinion.

52. Notwithstanding this, however, members of the group who were auditors of executing agencies felt that if the Board of Auditors was of the opinion that it was worth while to have the additional work carried out, they would be glad to co-operate. However, the nature and extent of work and the certificate to be provided would have to be reviewed further with the UNDP auditor and the members' own technical people. The question of additional costs, which could be significant, would have to be raised with the agencies involved. It was also noted that because audit plans for 1988 were finalized for the most part, only a limited amount of work in the area could be done for this biennium.

Recording unliquidated obligations:

53. The Group recalled that it was informed at last year's meeting that the Board was concerned that the recording of certain obligations, particularly those relating to purchases of equipment, which is based on contractual agreements and not on delivery, was no longer appropriate. This matter had been raised in both the 1986 and 1987 reports of the Board of Auditors; although it was felt the impact was significant, no estimate could be made of the magnitude. The Group also noted that both the UNDP administration and CCAQ took strong exception to these comments, arguing that the delivery principle was neither prudent nor practical. The Group was also informed that ACABQ did not agree with the delivery principle as well because in its opinion it interfered with the budgetary process.

54. While the Group agreed that the delivery principle for recording obligations was widely followed in the commercial sector and in many national Governments, the Group wondered whether the Panel should be disagreeing with the Governing Bodies without having an assessment of the impact on the financial statements.

55. Members felt that the probable abuse of the existing system should be the issue and that it would be worth while to examine the existing system from this perspective on an agency-by-agency basis with particular attention paid to the cancellation of unliquidation obligations. This matter could be reviewed next year and any significant problems reported to ACC.
Recommendations:

56. The Technical Group recommends that:

- The Board of Auditors continue further consultations with UNDP and the External Auditors on ways and means to receive audited accounts on UNDP operations on a timely basis, and on the nature and extent of the audit work required.

- The Panel of External Auditors carry out a review of the nature and extent of the possible abuses in the recording of unliquidated obligations and report back next year.

**Income recognition on cost-sharing arrangements (agenda item 7)**

Objectives:

57. To review the practice followed by UNDP of accounting for cost-sharing contributions on a cash basis rather than on an accrual basis as recommended by the Board of Auditors.

Summary of discussion:

58. The Group was informed that UNDP's projects are funded from the overall resources of the organization financed by donor countries through unrestricted voluntary contributions which are accounted for on a cash basis. However, projects funding can also be implemented on a project-by-project basis by cost-sharing contributions. In such cases, if project activities are not carried out as scheduled, the cost-sharing contributions received cannot be disposed of without the approval of the contributor. It has been the Board of Auditors' opinion that such restricted contributions should be accounted for on an accrual basis rather than a cash basis. Its view is that the accrual basis in this case is a more prudent method of accounting since these contributions accrue to the organization only to the extent that funds have actually been spent for the purpose for which they have been contributed. On the discussion that ensued, although the Group agreed in principle, it found difficulties in seeing the implications of the procedure without a quantification of the income received under cost-sharing arrangements vis-à-vis the total of other income. The Group also felt that there could be far deeper implications which should be analysed before a conclusion could be reached.

59. It was agreed that the member directly responsible for the audit of UNDP will prepare a note to be circulated to Group Members ahead of the meeting next year at which time the item will be reviewed again.