



**Office of Internal Oversight Services
Internal Audit Division II**

AUD: UNON (04/2006)

24 February 2006

TO: Mr. Klaus Töpfer, Director General
United Nations Office at Nairobi (UNON)

FROM: Corazon Chavez, Officer-in-Charge
Internal Audit Division II
Office of Internal Oversight Services

SUBJECT: **Audit of UNON Support Services: Commercial Operations (AA2005/211/04)**

1. I am pleased to submit the final report on the audit UNON Support Services: Commercial Operations, which was conducted in Nairobi, Kenya from July to October 2005, by Ms. Cécile Aptel-Williamson, Mr. Obin Silungwe, and Ms. Margaret Gichui-Nyiero. A draft of the report was shared with Director, Division Administrative services and the management and staff of Support Services Service, whose comments, which were discussed in a series of exchanges that took place in February 2006, are reflected in the attached final report, in italics.
2. I am pleased to note that all/most of the audit recommendations contained in this final report have been accepted and that UNON has initiated their implementation. The table in paragraph 57 of the report identifies those recommendations, which require further action to be closed. I wish to draw your attention to recommendations 02 and 03, which OIOS considers to be of critical importance.
3. I would appreciate if you could provide Mr C. F. Bagot with an update on the status of implementation of the audit recommendations not later than 31 May 2006. This will facilitate the preparation of the twice-yearly report to the Secretary-General on the implementation of recommendations, required by General Assembly resolution 48/218B.
4. Please note that OIOS is assessing the overall quality of its audit process. I therefore kindly request that you consult with your managers who dealt directly with the auditors, complete the attached client satisfaction survey form and return it to me.
5. I would like to take this opportunity to thank you and your staff for the assistance and cooperation extended to the audit team.

Attachment: final report and client satisfaction survey form

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**Office of Internal Oversight Services
Internal Audit Division II**

Audit Report

**Audit of UNON Support Services: Commercial Operations
(AA2005/211/04)**

Report date: 24 February 2006

**Auditors: Cécile Aptel Williamson
Obin Silungwe
Margaret Gichui-Nyiero**



**Office of Internal Oversight Services
Internal Audit Division II**

Audit of UNON Support Services: Commercial Operations
(AA2005/211/04)

EXECUTIVE SUMMARY

Between July and October 2005, OIOS conducted an audit of UNON's Commercial Operations.

Since 1972 when the United Nations presence in Africa was established in Nairobi, the Organization has taken various measures to help United Nations agencies, their staff and members of the diplomatic community cope with various situations in the country such as availability of commodities, fuel shortages, and also to promote awareness of the United Nations and the environment and to provide health, sports and recreational facilities. To provide these services, commercial operations such as a United Nations Commissary, Petrol Station, gift centre and recreation centre were established. In 2000 and 2001, OIOS reviewed existing commercial operations, and concluded that UNON generally had not managed these commercial operations in a business-like manner, and that there was little evidence of sound financial and administrative practices.

In light of organizational changes, taking into account recommendations made in the previous audit, this audit focused on the current overall arrangements for the management of commercial operations and specific arrangements for the management of the United Nations Commissary and United Nations Petrol Station. The audit covered activities with an income of approximately \$4 million from January 1999 to August 2005.

OIOS concluded that the management of the Commercial Operations Unit (COU) had improved. UNON had recruited a Manager with commercial expertise and re-designed roles and responsibilities of staff in COU to achieve operational effectiveness. UNON also identified an Integrated Commercial Operations System to be put in place after approval of the budget for the biennium 2006-2007, and reduced the percentage mark-up on fuel from 25 percent to a fixed rate of Ksh. 8.00 (US\$ 0.1) per litre. The audit identified a number of issues all of which were already addressed or under implementation at the time this final report was released. OIOS would like to thank UNON for the prompt action taken.

Organization and management of commercial operations

UNON has initiated action to review governance structures and financial reporting arrangements. Work is also underway to examine the link between overhead costs for administering the various commercial operations and the percentage mark-ups.

United Nations Commissary

UNON has improved its monitoring of Commissary operations since the last audit and *has outlined proposals to further improve performance monitoring*. To ensure that the Commissary continues to reflect the needs of the current user population and is able to be more responsive to changes in the nature of the population and availability of goods locally, OIOS recommended a

comprehensive review of the United Nations Commissary arrangements to determine the nature and type of United Nations Commissary arrangements that are now needed.

United Nations Petrol Station

The operation of the petrol station has improved since the last audit, and efforts are underway to address issues raised during this audit. *UNON has initiated action to recover excise duties amounting to approximately US\$250,000 over the period August to December 2005.*

February 2006

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I. INTRODUCTION

1. This report discusses the results of an OIOS audit of commercial operations activities administered by UNON Support Services, which was carried out between June and October 2005 in accordance with the International Standards for the Professional Practice of Internal Auditing.
2. Commercial operations such as the United Nations Commissary and Petrol Station were established in 1992 and 1995 respectively to help United Nations agencies, their staff and members of the diplomatic community cope with the problem of availability of commodities in the country, and fuel shortages experienced during the Gulf War in 1991.
3. Other operations such as a United Nations gift centre and recreation centre were established in 1991 and 2005 respectively to promote awareness of the United Nations and the environment and to provide health, sports and recreational facilities in an amiable, secure, and environmentally friendly atmosphere to United Nations staff members, their families and members of the diplomatic community.
4. Prior to 1996, existing commercial operations were managed by the United Nations Environment Programme (UNEP) and the United Nations Human Settlements Programme (UN-Habitat). UNON's Office of Administrative Services took up management of the commercial operations in 1996, through the Commercial Operations Unit (COU), under the Support Services Service.
5. A Commercial Operations Advisory Board (COAB) comprising representatives of United Nations Agencies, was established in 1999 to oversee the operations of COU and make recommendations to the Director, Division of Administrative Services. Prior to 1999 a governance body was in place, but this did not allow for full representation across United Nations Agencies.
6. COU is financially self-sufficient. It draws its income from mark-up on the various commodities and services provided, and manages these accounts independent of UNON administrative accounts. Over the period January 1999 to August 2005, COU generated an income of approximately US\$4 million, with a cumulative surplus of approximately US\$1.5 million as at 30 July 2005.
7. OIOS previously reviewed the United Nations Petrol Station in 1999 (AA1999/50/3) and Commercial Operations in 2000 (AA2000/16/4). The findings and recommendations were reviewed as part of this audit and any issues, which were still open, are discussed further in the body of the report.
8. A draft of the report was shared with Director, Division Administrative services and the management and staff of Support Services Service, whose comments, which were discussed in a series of exchanges that took place in February 2006, are reflected in the attached final report, in italics. UNON has accepted most of the recommendations and is in the process of implementation.

II. AUDIT OBJECTIVES

9. The overall objective of the audit was to provide the Director-General (DG), UNON with an

assessment of the adequacy of the arrangements for commercial operations under the responsibility of COU. This included:

- (a) Evaluating the adequacy, effectiveness and efficiency of internal controls;
- (b) Evaluating whether adequate guidance and procedures were in place;
- (c) Determining the reliability and integrity of the financial data;
- (d) Reviewing compliance with United Nations Regulations and Rules, and Administrative Instructions.
- (e) Assessing effectiveness and efficiency of arrangements for operations.

III. AUDIT SCOPE AND METHODOLOGY

10. The audit focussed on the adequacy of overall arrangements for management of commercial operations, and, the specific arrangements for management of the United Nations Commissary and United Nations Petrol Station. The gift shop was not reviewed at the request of UNON, because it was closed while an internal study was conducted into its future. The recreation centre was the subject of a separate audit (AA2005/211/03: Audit of UNON Support Services: Recreation Centre).

11. The audit covered activities for the period January 1999 to October 2005. It included a review and assessment of internal control systems, interviews with staff, analysis of applicable data and a review of the available documents and other relevant records.

12. OIOS also followed up on the implementation of the 20 recommendations raised in previous audits of commercial operations and the Petrol Station referred to above.

IV. AUDIT FINDINGS AND RECOMMENDATIONS

A. Organization and management of commercial operations

(a) Roles and responsibilities of Commercial Operations Unit (COU)

13. As recommended in the audit report on commercial operations (AA2000/16/4/11), a review of the roles and responsibilities was conducted by an external consultant in 2002, with the intention to implement the findings when the commercial operation's manager was appointed. The manager was appointed in October 2004, and at the time of the audit he was in the process of implementing the findings. Progress with implementation was considered satisfactory. The recommendation is closed and OIOS does not propose any further action.

(b) Roles and responsibilities of Commercial Operations Advisory Board (COAB)

14. As recommended in the audit report on commercial operations (AA2000/16/4/11) a review of the roles and responsibilities was conducted by an external consultant in 2002. OIOS reviewed and noted that the recommendations of the consultant were out of date and needed to be reviewed.

15. UNON commented that it had initiated a review of Governance Structures and Financial Reporting arrangements for COU and that this review should be completed by mid 2006. OIOS thanks UNON for this additional information and does not propose any further action.

(c) Staffing

16. As recommended in the last audit of commercial operations (AA2000/16/4/013), the commercial operations manager reviewed and amended the roles and responsibilities of COU staff, but at the time of issuing the draft report, staff job descriptions had not yet been updated and submitted for reclassification, as per ST/AI/1998/9, which requires reclassification “when the duties and responsibilities of the post have changed substantially or as a result of a restructuring within an office....”. The old recommendation is closed and replaced with the following.

Recommendation:

- To ensure formal adoption of the re-designed structure for UNON commercial operations, UNON should prepare job descriptions in line with the new structure and submit them to UNON Human Resource Services for approval and reclassification, and ensure that staff performing these functions possess the skills and competencies required for the positions, and that the new job descriptions are reflected in the work plans produced for the performance appraisal system (Rec. 01).

17. UNON accepted this recommendation and the estimated implementation date is April 2006. OIOS thanks UNON for the prompt action taken and will close the recommendation upon receipt of a copy of the classified job descriptions, and confirmation that they have been used for 2006-2007 PAS cycle.

(d) Accounting policies and procedures

18. OIOS is concerned that its recommendations on accounting policies and procedures for commercial operations, in accordance with United Nations accounting standards, (AA2000/16/4/06, 09 and 10) are still open and there was no evidence of any action plan to address these issues. As a consequence, there was no evidence of adequate accounting controls to ensure the accuracy and completeness of accounting information for commercial operations. These recommendations remain open and OIOS encourages UNON to implement them as quickly as possible, to minimize the risks associated with financial management.

(e) Reporting of COU budget and accounts under UNON programme budget and accounts

19. OIOS recommended in 2000 that UNON should comply with Financial Rule 107.4 by including the COU budget and accounts in UNON’s programme budget and accounts (AA2000/16/4/005). The existing recommendation has been overtaken by events and has been closed. UNON commented that it had initiated a review of Governance Structures and Financial Reporting arrangements for COU and that this review should be completed by mid 2006. OIOS thanks UNON for this additional information and does not propose to take any further action.

(f) Customer satisfaction

20. As recommended in its prior audit of commercial operations (AA2000/16/4/012), UNON conducted client satisfaction surveys, but there was no evidence that the surveys led to any changes or improvements. Consequently, OIOS concluded that COU lacked the expertise to put in place an effective mechanism to collect and analyse customer information to assist in improving commercial operations. The old recommendation is closed and in the light of the following information, OIOS is not proposing any further action on this issue. *UNON commented that work is underway to ensure that meaningful performance information is collected on UNON commercial operations:*

- *In June 2005 a consultant with experience in the catering and hospitality industry was recruited. This consultant has been involved in, among other things, the design and development of mechanism(s) for identifying and measuring whether client expectations are being met. The initial focus has been on catering and the UN Commissary (UNC), but the scope will be widened to include all commercial operations in the future.*
- *In March 2005, the Chief, Commercial Operations Unit prepared a document outlining key performance measures to be used for identifying and measuring client expectations for the UNC. This was a supporting document justifying the extension of the current contractor's contract for another 12 months. A review of the UNC's performance is due in February 2006, after which any required adjustments will be made.*

21. *A catering survey which proved to be very successful (elicited over 320 responses, 250 in the first two days) was completed in February 2006. An online planning / inventory management tool based on customer purchases and surveys is under consideration. Estimated implementation date: December 2006.*

(g) Information technology

22. OIOS in 2000 recommended that UNON should determine COU's information technology requirements and prepare an action plan for implementing these requirements (AA2000/16/4/015). Whilst there was evidence that critical systems had been identified and planned to be purchased as part of purchase of an Integrated Commercial Operations System in the 2006, these did not form part of any detailed analysis of information requirements, which OIOS considers is critical for the long-term success of commercial operations, and hence the recommendation is kept open.

(h) Percentage mark-up and recovery of overhead costs

23. Since the restructuring of COU in 2005, COU is now in a position to quantify its overhead costs for administering the various commercial operations. However, a mechanism needs to be developed to link these overhead costs to the various percentage mark-ups that should be charged to each activity, to ensure that COU only charges what is necessary to sustain itself while ensuring competitive prices. *UNON commented that procurement activity is limited to that mandated under the Host Country to control importation of tax-free goods (e.g. requesting approval of PRO-IB from Ministry of Foreign Affairs). The contractor operating the UN Commissary handles all other procurement and importation administration. COU personnel undertake receipt and inspection procedures.*

Recommendation:

- To ensure reasonable mark-ups on commodities and reimbursement of costs incurred in administration of UNON commercial activities, UNON should develop a mechanism to link overhead costs for administering the various commercial operations to the percentage mark-ups, (Rec. 02).

24. *UNON commented that it accepts this recommendation and will conduct the formal review of mark-ups by the end of 2006. Efforts are underway to quantify the cost of administering commercial contracts. Estimated implementation date: December 2006.* OIOS notes the response and will close the recommendation upon receipt of a copy of the mechanism to link overhead costs for administering the various commercial operations to the percentage mark-ups.

B. United Nations Commissary

(a) Rationale for and design of the United Nations Commissary

25. When the United Nations presence in Africa was established in Nairobi in 1972, the availability of commodities was very limited and the United Nations staff members were required to ship supplies to last them for long durations. To alleviate this problem, the United Nations Environment Program (UNEP) and the United Nations Human Settlements Programme (UN-Habitat), entered into an agreement with Kenya to enable them to establish a United Nations Commissary for sale of agreed articles to their officials and members of accredited delegations.

26. Over the years, there has been an increase both in the number of United Nations agencies served by the United Nations Commissary (over 3,000 customers) and the range and nature of international goods available in the local market place, but there has not been any comprehensive review of the nature and type of United Nations Commissary that is now needed, if one is still needed.

Recommendation:

- To determine the continued need for a United Nations Commissary in Nairobi, and to ensure that the United Nations Commissary reflects the needs of the enlarged United Nations community now present in Nairobi, UNON should undertake a review into the need for a United Nations Commissary and, if one is needed, what services it should provide, the mechanism for its operation, and whether the United Nations Commissary should be run by UNON or outsourced. Formal review of services provided at Vienna and New York should be included as part of this review (Rec. 03).

27. *UNON commented that it accepts this recommendation: Due by mid 2007 in time for the opening of the new Commissary.* OIOS notes the response and will close the recommendation upon receipt of a copy of the results of the review into the need for a United Nations Commissary and, if one is needed, what services it should provide, the mechanism for its operation, and whether the United Nations Commissary should be run by UNON or outsourced.

(b) Operation of the United Nations Commissary

28. The United Nations Commissary, since its establishment in 1992, has been outsourced to commercial contractors due to the lack of in-house expertise, which has meant that UNON has been unable to properly control and demonstrate that the United Nations Commissary represents value for money to staff. In October 2004, UNON hired a manager with commercial expertise putting UNON in a position where it has the expertise to review whether it would be more cost effective for UNON to play a more significant role in running the United Nations Commissary. This issue has been addressed in recommendation 03 above and no further action is proposed.

(c) Policies/procedures for operation and use of the United Nations Commissary

29. Policies on use and operation of the United Nations Commissary have been drafted, but have not been finalized or communicated to users and affected parties. This issue has been addressed in recommendation 03 above and no further action is proposed.

(d) Monitoring operations of the United Nations Commissary

30. OIOS recommended (AA2000/16/4/002) that to ensure that the contractor operating the United Nations Commissary was delivering a satisfactory level of service, UNON should review and make recommendations on pricing of goods, profit margins payable and arrangements for monitoring all aspects of contract performance. This recommendation has been closed on the basis of the information provided below:

(i) Initial pricing of commodities

31. Initial pricing of commodities sold at the United Nations Commissary is dependent on percentage mark-up on the landing cost (proceeds to the contractor), ranging between 14 to 17 percent for various commodity groups. The landing costs are dependent on origin, quantity and shipping and handling. The first two are left to the contractor's expert judgement, while shipping and handling were reviewed by UNON in 2000, and the cheapest option determined for a trial period of six months, eliminating excessive costs ranging from US\$4,000 to US\$10,000. As a consequence of the above, UNON explained that like commodities available in the local market could be cheaper or more expensive depending on origin and quantity. These conditions appear never to have been revisited since 2000 and there has never been any consideration of a clause in the contract that the contractor should guarantee to always sell at the same or lower price than can be obtained in the local market place.

32. *UNON commented that it has already put in place procedures to ensure monthly price comparisons are conducted as part of the key performance measures the operator has been asked to comply with. As part of the recommendation to the Local Committee on Contracts (LCC) to extend the contract of the existing contractor in March 2005, a very clear set of nine Key Performance Measures (KPMs) were identified. The second KPM (3.3.2) clearly stated that there would be ‘..an ongoing focus on price through extensive surveys and price comparisons of the local market’. The operator has conducted regular price surveys through external data collection companies, and UNON has also now agreed as part of this KPM that the operator will conduct a formal ‘Trolley for Trolley’ comparison once a month (starting February 2006) to prove that on average, for a monthly shop covering approximately 50 purchased items, the UN Commissary is consistently about 30% cheaper than the local market leader. UNON would also like to explain that volume advantage to local supermarkets must also be taken into account – this sometimes erodes the tax-free differential. OIOS thanks*

UNON for the clarification and will close the recommendation AA2000/16/4/002.

(ii) Shelf pricing of commodities

33. Shelf pricing of commodities sold at the United Nations Commissary is dependent on the five percent mark-up on the contractor's / retail price for luxury items (proceeds to COU). OIOS established in its last audit (AA2000/16/4) that there was no basis for the five percent mark-up and why it was only levied on luxury items. At the time of this audit, COU were still unable to link the overhead costs of COU to the percentage mark-up and this part of the old recommendation is dealt with under the earlier section on percentage mark-up and recovery of overhead costs.

(iii) Quality of commodities

34. In contrast to prior periods, the audit noted an improvement in the quality of commodities sold at the United Nations Commissary, for example, the quality of sports wear and equipment is now comparable to the leading sports outlet in Nairobi. This is further reinforced by the introduction of performance measures mentioned in paragraph 32.

(iv) Planning for sufficient supply of commodities

35. During the audit, OIOS noted that popular commodities were bought at a very high rate and replenishment of the same commodity was only effected after durations of between two weeks to four months, for example Janisberg wines, 5 litre juices, all chocolates, and Channel No 5 perfume. UNON has put in place measures to address this issue, which are described in paragraph 32 above.

(v) Financial monitoring

36. In the absence of automated systems in COU, monitoring implementation of the contract for the United Nations Commissary has proved to be difficult due to the absence of a link to the contractors systems, thereby only allowing for manual checking of volumes of transactions (average of 1,000 sales with a daily value of approximately US\$12,000). The presence of the contractor in the compound and availability of all United Nations Commissary transactions provide a good monitoring environment, which COU has not been able to take advantage of due to lack of resources required to conduct manual checks. OIOS is of the opinion that the proposed purchase of an Integrated Commercial Operations System in the 2006 will address this issue and no further action is proposed.

(e) Entitlement and access to duty-free commodities

37. The Executive Directors of UNEP and UN-Habitat have been delegated authority by the Kenyan Government to issue regulations on reasonable quantities of agreed articles for use by its staff and members of delegations. UNON being the administering authority for this activity, has issued regulations on allowed quantities for different levels of staff as follows:

Staff Level	Approximate Net Salary per month (US\$)	Commissary value ceiling per month (US\$)	Salary portion allowed under ceiling (%)	Restrictions		
				Spirits (litres)	Other alcoholic beverages (litres)	Tobacco – assorted (grams)
G1 – G4	360 – 880	198	55 - 22	2	4	500
G5 – G7	1,100 – 1,700	463	42 - 27	2	4	500
International GS		900				
National Officers and UN Volunteers	2,600 – 5,200	1,000	38 - 19	12	60	1,500
P1 – P4	2,900 – 5,300	1,000	34 - 18			
P5 – D1	6,350 – 7,500	1,670	26 - 22			
D2 – USG	8,200 – 10,700	2,210	27 - 21			
Permanent representatives		1,670		Unlimited	Unlimited	Unlimited
Members of delegations		1,670				

38. While UNON has established a mechanism to control abuse of privileges by suspension or complete withdrawal depending on severity, the privilege scale has not been reviewed since 1992, and OIOS is of the opinion that the above table suggests that a review is needed to better align privileges with salary levels. As can be seen from the table above, the allowance for a G1/2 is around 50 percent of their take home pay, which increases the likelihood that purchase in this category may be for private sale rather than home consumption. *UNON commented that the statistics above do not take into account the total disposable income at these grades, since the majority of staff below the G3 level are in roles that include an overtime entitlement (e.g. Security Officers and Drivers), which could be quite significant in relation to their actual income. UNON believes that the problem is in the area of the table marked 'unlimited' and proposes to look further into whether limits should be placed on all levels.* OIOS thanks UNON for the clarification and agrees with the proposal to look into placing a limit on all categories of staff.

Recommendation:

- To strengthen UNON’s mechanism for control of abuse of duty-free privileges, UNON should develop a branding mechanism to identify commodities sold at the United Nations Commissary from those available in the local market (Rec. 04).

39. *UNON commented that it accepts this recommendation, which will form part of the contract negotiated for the new commissary. Estimated implementation date: Mid 2007.* OIOS notes the response and will close the recommendation upon receipt of details of branding mechanism to identify commodities sold at the United Nations Commissary from those available in the local market.

C. United Nations Petrol Station

(a) Rationale and design for the United Nations Petrol Station

40. As a result of fuel shortages experienced during the Gulf War in 1991, the United Nations in Nairobi decided to establish a petrol station to cater for emergencies. Operation of the United Nations Petrol Station commenced in 1995 and catered for United Nations official vehicles and staff vehicles with diplomatic number plates. Because of problems experienced in use of commercial petrol stations, the Ministry of Foreign Affairs, in 1998, directed all Embassies /

High Commissions and International Organizations to purchase duty-free fuel from the United Nations Petrol Station. The need for the United Nations to maintain its own petrol station to cope with emergencies remains. However, the increase in number of United Nations and diplomatic staff and the growth of reliable sources of petrol nationwide, such as Shell Ltd. with 131 service stations and Kenol/Kobil Ltd. with 185 service stations nationwide, has not resulted in any review of whether usage of the United Nations Petrol Station could be supplemented by use of commercial petrol stations nationwide, using some form of an enhancement of the existing electronic card system.

41. *UNON commented that the current political situation in Kenya does not warrant the use of the fuel station just to deal with emergencies. Currently, the primary use of the petrol station is the supply of the duty free fuel to those so entitled. The current Host Country agreement places no limit on the amount of duty free fuel that can be purchased and UNON sees no value in opening this discussion. The Kenyan Government does not currently require local fuel stations to provide the facility to diplomats or United Nations staff to purchase fuel at duty paid prices, and then receive a receipt identifying excise duties to allow for individual claims. The Kenyan Government asked UNON to provide a solution to duty exempt customers through supply of duty free fuel through the UNON fuel station. UNON believes it has demonstrated willingness to comply with this, and by doing so is able to provide a beneficial service to both United Nations staff and also to the wider diplomatic community.* OIOS thanks UNON for the clarification and proposes no further action beyond requesting that this issue be kept under review and discussed at the Host Country Liaison Committee should a need to revise this situation occur.

(b) Policies/procedures on use and operation of the United Nations Petrol Station

42. Policies on use and operation of the United Nations Petrol Station have been drafted, but have not been finalized or communicated to users and affected parties. OIOS was informed that they would be issued March 2006 and therefore OIOS proposes no further action.

(c) Monitoring operations of the United Nations Petrol Station

43. OIOS recommended (AA1999/50/3/001) that the COAB, in consultation with UNON, should document what costs should comprise the operational costs of the COU and determine what percentage mark up is required to cover these costs; and (AA1999/50/3/002) develop a policy on any additional percentage mark up above that required to cover operational costs. UNON explained that the recommendation had not been implemented because of the following.

(i) Initial pricing of fuel

44. Initial pricing of fuel sold at the United Nations Petrol Station is dependent on mark-up on the landing cost (proceeds to the contractor), of Ksh 3.75 (US\$0.04) per litre of diesel (mark-up was reduced to 2.75 for one month only in October when the high price of Diesel made it almost impossible to sell at the UNON Fuel station) and Ksh 3.95 (US\$0.05) per litre of petrol. These mark-ups have however not been documented in the contract document between UNON and the contractor, and COU does not know how these figures were arrived at or whether they were reasonable. *UNON commented that UNON considers the current markups of 3.75 and 3.95 Kenya Shillings per litre of diesel and petrol respectively as reasonable. This is the status now and has been for the past many years. UNON will ensure that any change in the markup is reflected in an amendment to the current contract.* OIOS thanks UNON for the clarification and has closed recommendation AA1999/50/3/001.

(ii) Dispensing price of fuel

45. Dispensing price of fuel sold at the United Nations Petrol Station was dependent on COU's mark-up on the contractor's / retail price. COU in October 2005 revised the 25 percent mark-up (Ksh. 13.72) previously applied to a fixed rate of Ksh. 8.00 (approximately US\$0.1) per litre. Despite the reduction, the market rate for diesel (duty paid) in October 2005 was Ksh. 63.49, whereas it sold for Ksh. 62.40 at the United Nations Petrol Station. As a result, and in contrast to petrol, there was hardly any price difference between duty free sold at the United Nations Petrol Station and duty paid diesel sold at any other Petrol Station, which defeats the purpose of granting tax free privileges to the United Nations and its staff members. OIOS established in its last audit (AA1999/50/3) that there was no basis for the initial mark-up, which was more than sufficient to cover the operational and administrative costs of COU. At the time of this audit, COU were still unable to link the overhead costs of COU to the mark-up and this part of the old recommendation is dealt with under the earlier section on percentage mark up.

(iii) Financial monitoring

46. At the time of the audit, monitoring implementation of the United Nations Petrol Station contract was limited to manual checking of sales with a daily value of US\$7,000, and OIOS questioned the effectiveness of the manual checking given the high volume of transaction. This was recognised by UNON, and OIOS is of the opinion that the proposed purchase of an Integrated Commercial Operations System in the 2006 will address this issue and no further action is proposed.

(d) Access to duty-free fuel

47. OIOS recommended that (AA1999/50/3/004) the COAB, in cooperation with UNON, should strengthen the procedures to ensure the proper return of Petrol Coupon Books (PCBs). These procedures should consider maintenance of records on expected return date, stamping the staff member's contract expiration date and model of the vehicle on the petrol coupon book, or replacing the petrol book with an electronic card showing the plate number and contract expiry date of the user. At the time of the audit, this recommendation had not been fully implemented because, though COU had introduced electronic debit fuel cards in October 2001, coupon books were still being used alongside the fuel cards. The introduction of this system was met with resistance from staff resulting in staff being allowed to retain coupon books. COU informed OIOS that strict application of the electronic fuel cards would be effected by January 2006, but there was no evidence that staff concerns had been addressed such as, monthly cash advances, no statements on usage, inconvenient times to top-up. While this action will close the old recommendation, the fuel card does not seem to fully address the needs of users. *UNON commented with regard to OIOS proposal to consider changing the existing debit card to a credit card, that the introduction of such credit card was not possible for the reasons outlined earlier (paragraph 41). UNON recognises the concerns raised by staff and is looking into more client friendly methods for receiving payments which do not compromise UNON's need to exercise control over use of the petrol station. UNON intends to have new measures in place by the end of 2006.* OIOS thanks UNON for the additional information and proposes no further action.

(e) Insurance and liabilities to third parties

48. The United Nations Petrol Station was not insured as required by the contract, and UNON

had never checked that this control was in place as is required by paragraph 13.6.3 of the procurement manual, “procurement officers should assess whether additional terms on insurance should be enforced especially... provision of fuel...”

Recommendation:

- To ensure adequate coverage of risks pertaining to contractual services within the United Nations premises in Nairobi, UNON should obtain insurance policies from current contractors in accordance with the terms of the contracts (Rec. 05).

49. *UNON commented that it accepts this recommendation in the context in which is raised i.e. to obtain copies of the existing insurance policies in place for the fuel station from the operator. Estimated implementation date: June 2006.* OIOS notes the response and will close the recommendation upon confirmation that UNON has copies of the insurance documents and can confirm that they cover what is stated in the terms of the contract.

(f) Payment of duty/tax to the Kenyan Government

(i) Tax embedded in pricing

50. While UNON has an agreement with the Kenyan government for provision of fuel, free of any taxes as stated in Article VIII (d) of the Host Country Agreement, “Articles imported...shall be exempt from customs duties and other levies...”, the sale price to COU by the contractor consists of:

- a) A tariff excised by the Kenya Pipeline Corporation (KPC) comprising 18 percent Value Added Tax (VAT). This amounts to Ksh. 0.33 (US\$0.005) per litre, which OIOS estimates amounts to approximately US\$3,800 (or less depending on the VAT percentage at time of purchase) from May 2002 (initial contract agreement) to September 2005, based on the quarterly supply of 60,000 litres.
- b) Fuel Levies excised by the government at Ksh. 5.91 (US\$0.08) per litre, which OIOS estimates to be approximately US\$68,380 from May 2002 to September 2005, based on the quarterly supply of 60,000 litres.

51. OIOS is of the opinion that based on the Host Country Agreement, COU has a right to claim from the Kenyan government a reimbursement of approximately US\$72,000.

52. *UNON commented that it can only claim back Excise duties. Other taxation generated further down the supply chain (such as VAT on transportation cost through Kenya Pipeline Company KPC) is not claimable based on Kenyan Government regulations. All other duty exempt organizations in Kenya comply with these regulations, and the Kenyan Government will not consider changing the procedures for one customer, whose consumption is small in relation to other users. UNON has initiated action to claim back excise duties, which over the period August to December 2005 should equate to approximately US\$250,000.* OIOS thanks UNON for the prompt action taken and proposes no further action beyond recording in its annual report, as part of the global figures of savings realised estimated at US\$1.2 million a biennium.

(ii) Reimbursement of duty paid on fuel

53. COU entered into a credit arrangement with the contractor in August 2005, due to change of importation procedures by the Kenya Revenue Authority, requiring payment of an advance tax at the point of entry, which was offset against the actual tax claim at a later date. This was done because COU did not have adequate reserve funds in its account at the time. The credit amount of Ksh. 0.482 embedded in the dispensing price to the consumer was approximately US\$1,900, against duty of approximately US\$62,800 for the August import of 270,000 litres. While the credit amount appears to be reasonable against the duty amount, OIOS is concerned about the legality of this arrangement. *UNON commented that it has already raised the issue of excise duty payment and re-imburement with the Host Country Liaison Committee (HCLC), and in line with the privileges set out in the Host Country Agreement is pursuing an exemption from, or a waiver for the payment of Excise duties on fuel, which was introduced in August 2005 by the Kenyan Government.* OIOS thanks UNON for the clarification and proposes no further action.

(iii) Duty paid on other commodities sold at the United Nations Petrol Station

54. The contract agreement with the fuel provider does not protect United Nations staff members from paying tax on commodities other than fuel. OIOS is of the opinion that this is not in accordance with Article VIII (e) and (f) of the Host Country Agreement (HCA), “...exempt from ...duties and other levies.... on spare parts...The Government shall, if requested, grant...such facilities for the procurement of gasoline or other fuels and lubricating oils...at such special rates as may be established for diplomatic missions...” As UNON does not have a supplementary agreement with the Kenyan government for provision of duty-free fuel, similar to that of the United Nations Commissary, outlining particular articles to be sold, negotiations leading to such an agreement may be appropriate. *UNON commented that only fuel sales are exempt from duties in the current Host Country agreement. Sales of the other items listed above are not included in the Host Country agreement.* OIOS notes the response and does not propose any other further action beyond requesting inclusion of issue in the proposed review of Commissary (recommendation 3 above).

(g) Handling of cash

55. COU provides opportunities for students to gain commercial experience through the United Nations Internship programme. While this effort is commendable, COU should ensure that the interns are properly supervised and that critical operations involving organizational resources such as cash are not handled by interns without any supervision by United Nations staff members. *UNON commented that on-site representation by COU GS staff is now controlled through a formal rota system, which is approved and signed off on a weekly basis. The three administrative staff in COU are included on the morning and afternoon shifts, and their performance is measured based on the accuracy of the end of shift control report. Although interns work at the Fuel Station, they are supervised at all times by a COU staff member who has full responsibility for the financial control of the site.* OIOS thanks UNON for the prompt action taken and proposes no further action.

(h) Relocation of the United Nations Petrol Station

56. UNON entered into a 15-year contract with the fuel provider in 2004 to enable the contractor to recover the investment amount for relocation of the United Nations Petrol Station to the perimeter fence of the United Nations complex. OIOS’ review of the procurement processes involved raised doubts about the transparency and fairness of the exercise and is looking into this issue separately.

V. FURTHER ACTIONS REQUIRED ON RECOMMENDATIONS

57. OIOS monitors the implementation of its audit recommendations for reporting to the Secretary-General and to the General Assembly. The responses received on the audit recommendations contained in the draft report have been recorded in our recommendations database. In order to record full implementation, the actions described in the following table are required:

Recommendation No.	Action Required
Rec. 01	Receipt of a copy of the classified job descriptions, and confirmation that they have been used for 2006-2007 PAS cycle.
Rec. 02	Receipt of a copy of the mechanism to link overhead costs for administering the various commercial operations to the percentage mark-ups.
Rec. 03	Receipt of a copy of the results of the review into the need for a United Nations Commissary and, if one is needed, what services it should provide, the mechanism for its operation, and whether the United Nations Commissary should be run by UNON or outsourced.
Rec. 04	Receipt of details of branding mechanism to identify commodities sold at the United Nations Commissary from those available in the local market.
Rec. 05	Confirmation that UNON has copies of the insurance documents and can confirm that they cover what is stated in the terms of the contract.

VI. ACKNOWLEDGEMENT

58. I wish to express my appreciation for the assistance and cooperation extended to the audit team by management and staff of UNON.

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