



INTERNAL AUDIT DIVISION

OFFICE OF INTERNAL OVERSIGHT SERVICES

REPORT

**Review of actions taken to strengthen
financial management and the internal
control system in the United Nations
Office for Project Services**

15 November 2007

Assignment No. AP2007/850/01

United Nations  Nations Unies

INTEROFFICE MEMORANDUM

MEMORANDUM INTERIEUR

INTERNAL AUDIT DIVISION · DIVISION DE L'AUDIT INTERNE
OIOS · BSCI

TO: Mr. Warren Sach
A Assistant Secretary-General and the Controller
Office of Programme Planning, Budget and Accounts

DATE: 15 November 2007

REFERENCE: AUD-7-5: (07- 00740)

FROM: Dagfinn Knutsen, Director
DE: Internal Audit Division, OIOS



SUBJECT: **Assignment No. AP2007/850/01 - Review of actions taken to
OBJET: strengthen financial management and the internal control system in
the United Nations Office for Project Services**

1. I am pleased to present the report on the above-mentioned review, which was conducted from 17 September to 8 October 2007, pursuant to your request of 20 July 2007.

2. During the field work at UNOPS headquarters in Copenhagen, OIOS also reviewed a number of related contracts and documentation provided by UNOPS New York Office and by the United Nations Mine Action Service (UNMAS) of the Department of Peacekeeping Operations. Some issues raised by OIOS during the review may require action by the United Nations to improve internal controls in administering projects implemented by UNOPS. These issues are discussed in paragraphs 21, 48, 71 and 78.

3. Please note that under General Assembly resolution 59/272, a Member State may request that the final report of this review be made available. It is therefore important that we receive your comments and clarifications prior to finalizing the report so that they can be incorporated into the report.

4. IAD is assessing the overall quality of its audit process and kindly requests that you consult with your managers who dealt directly with the auditors and complete the attached client satisfaction survey form.

cc: Mr. Jan Mattsson, Executive Director, UNOPS
Mr. Swatantra Goolsarran, Executive Secretary, UN Board of Auditors
Mr. Jonathan Childerley, Chief, Oversight Support Unit, DM
Mr. Byung-Kun Min, Programme Officer, OIOS

INTERNAL AUDIT DIVISION

FUNCTION

“The Office shall, in accordance with the relevant provisions of the Financial Regulations and Rules of the United Nations examine, review and appraise the use of financial resources of the United Nations in order to guarantee the implementation of programmes and legislative mandates, ascertain compliance of programme managers with the financial and administrative regulations and rules, as well as with the approved recommendations of external oversight bodies, undertake management audits, reviews and surveys to improve the structure of the Organization and its responsiveness to the requirements of programmes and legislative mandates, and monitor the effectiveness of the systems of internal control of the Organization” (General Assembly Resolution 48/218 B).

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EXECUTIVE SUMMARY

Review of actions taken to strengthen financial management and the internal control system in the United Nations Office for Project Services

OIOS conducted a review of actions taken to strengthen financial management and the internal control system in the United Nations Office for Project Services (UNOPS) from 17 September to 8 October 2007. The review was conducted at the request of the UN Controller in view of: (i) a qualified opinion issued by the Board of Auditors (BOA) on UNOPS' financial statements for the biennium 2004-2005; (ii) concerns expressed by the BOA on the ability of the Office to operate as a going concern; and (iii) identified internal control weaknesses in finance, procurement, asset management and other areas of UNOPS operations.

The main objectives of the review were to assess (i) progress made by UNOPS to implement the BOA recommendations addressing internal control weaknesses and concerns about UNOPS' ability to continue its operations; and (ii) the adequacy of financial management practices relating to projects funded by the United Nations Secretariat.

Based on the results of the review, OIOS concluded that there was a high risk relating to UNOPS' ability to continue as a going concern due to the low level of operational reserve, long-outstanding unsettled receivables from the United Nations Development Programme (UNDP), and unrecorded liabilities for after-service health insurance (ASHI). Moreover, most of the BOA recommendations addressing internal control weaknesses are still to be implemented by UNOPS. In this regard, UNOPS commented that its provision for ASHI liabilities compared favourably with the majority of UN organizations because UNOPS began accruing ASHI liabilities proactively as of 1 January 2004. However, since UNOPS is a self-financing organization, having adequate provision for long-term liabilities is considered more critical to ensure it is a going concern entity, as compared to organizations financed by the UN budget.

OIOS found that during the past fifteen months, the newly appointed UNOPS' senior management made efforts to launch several initiatives and reforms to improve UNOPS operations. In September 2007, UNOPS exceeded the project delivery target for 2007, which may indicate that UNOPS can further expand its business and improve its financial position in the coming years. Closely monitoring of UNOPS operations will be needed to assess the efficiency and effectiveness of the reforms and initiatives that are currently in progress.

OIOS identified the following areas that UNOPS management needs to address in order to improve internal controls and secure its financial viability:

- Promptly implementing the BOA recommendations to address internal control weaknesses (paras.10-12);

- Settling the long-outstanding receivables of \$9.9 million from the United Nations Development Programme (para.13);
- Increasing its operational reserve to the required level (para.14);
- Making adequate provisions for after service health insurance (paras.16-19);
- Strengthening the Strategy and Audit Advisory Committee and ensuring its independence (paras.27-31);
- Improving its contract award process and ensuring transparency in contract negotiations (paras.32-50);
- Reconciling a \$3.6 million difference between the cash balance shown in the UNOPS cash book and in the bank reconciliation prepared by UNDP in carrying out the treasury function for UNOPS (paras.52-57); and
- Timely preparation and submission of quarterly/yearly financial statements for individual projects to avoid delays in installment payments (64-69).

During the review, OIOS also identified the following issues that may require action by the United Nations to improve internal controls in administering projects implemented by UNOPS:

- There is a need for the governing bodies of UNOPS to establish a mechanism for closely monitoring UNOPS operations and the results of the reforms undertaken by UNOPS management in order to improve UNOPS' financial standing and secure its ability to continue as a going concern (para. 21);
- To ensure transparency and accountability in procurement operations, UNMAS' roles and responsibilities in the procurement process related to UNOPS projects need to be clearly established and formalized in respective manuals or procedures (para. 48);
- Consideration should be given to assigning UNMAS a separate cost center in order to reduce the lead time in processing installment payments by eliminating the need to request funds through DFS. In addition, a timeline within which the initial installment payment should be made to UNOPS needs to be defined (para.71); and
- Considering that the value of the projects implemented by UNOPS exceeds \$120 million, there may be a need for UNMAS to establish and formalize a proper accountability mechanism to obtain assurance that project expenditures and the UNOPS management fees are properly charged (para.78).

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I. INTRODUCTION

1. OIOS conducted a review of actions taken to strengthen financial management and the internal control system in the United Nations Office for Project Services (UNOPS) from 17 September to 8 October 2007.

2. Until 31 December 1994, the Office for Project Services was part of the United Nations Development Programme (UNDP). In June 1994, in its decision 94/12, the Executive Board of UNDP and the United Nations Population Fund (the Executive Board) recognized the need for a self-financing Office for Project Services and recommended to the General Assembly that the Office for Project Services should become a separate and identifiable entity in a form that did not create a new agency. Based on the decision of the General Assembly (48/501 of 19 September 1994) and the Executive Board's decision 94/32 dated 10 October 1994, UNOPS was established as a separate self-financing entity within the United Nations system effective 1 January 1995.

3. The United Nations Board of Auditors (BOA) issued a disclaimer of opinion in its report on the audit of UNOPS for the biennium ending 31 December 2003 (A/59/5/Add.10). The BOA also issued a qualified opinion on the financial statements of UNOPS for the period ended 31 December 2005 (A/61/5/Add.10) relating to an interfund account receivables amounted to \$9.9 million from UNDP. In addition, the BOA has expressed concerns about the effectiveness of UNOPS' internal controls and the Office's ability to continue as a going concern. In his memorandum dated 20 July 2007, the UN Controller requested OIOS to conduct a "review and evaluation of the internal controls and financial management practice at UNOPS".

4. The UNOPS management prepared interim (unaudited) financial statements for year ending 31 December 2006 and reported operational results of 2006 to the Executive Board in May 2007. However, the actual financial position of UNOPS needs to be ascertained after UNOPS' financial statements for the biennium 2006-2007 are audited by the BOA.

5. UNOPS operations are guided and administered by UNOPS Financial Regulations and UNDP Financial Rules, which apply *mutatis mutandi* to UNOPS. However, some of UNDP rules applied to UNOPS refer to functions or responsibilities, which UNOPS does not have or performs in a different way.

6. Comments made by UNOPS on a draft of this report are shown in *italics*.

II. OBJECTIVES

7. The objectives of the review were to assess: (i) progress made by UNOPS to implement the BOA recommendations addressing internal control weaknesses and concerns about UNOPS' ability to continue its operations; and (ii) the adequacy of financial management practices relating to projects funded by the United Nations Secretariat.

III. SCOPE AND METHODOLOGY

8. The review was limited to assessing certain aspects of UNOPS operations in 2006 and 2007 in order to identify risks that may adversely impact the timely and effective delivery of UNOPS services. As part of the field work, OIOS reviewed to a limited extent policies and procedures concerning: (i) the establishment of Memorandums of Agreement (MOA) between UNOPS and the United Nations Secretariat; (ii) processing of installment payments to UNOPS; and (iii) arrangements for the procurement or mine action support for UNOPS projects. OIOS also reviewed the selected contracts and documentation provided by UNOPS New York Office and by the United Nations Mine Action Service (UNMAS) of the Department of Peacekeeping Operations.

9. OIOS also examined selected internal control processes at UNOPS by testing judgmental samples of transactions to obtain reasonable assurance about the progress made by UNOPS in improving its operations and internal controls. In conducting this review, OIOS relied to a certain extent on the work done by the BOA, as well as the results of the audits conducted by UNDP/UNOPS internal auditors.

IV. AUDIT FINDINGS AND RECOMMENDATIONS

A. Implementation status of the Board of Auditors recommendations

10. OIOS reviewed the implementation status of recommendations made by the BOA in its recent report on UNOPS operations (A/61/5/Add.10). At the time of the review, out of a total of 43 recommendations, 4 had been implemented, 32 were in progress and 7 had not been started. According to UNOPS, 28 recommendations will be implemented by the end of December 2007. The improvement in internal controls of UNOPS operations will, to a large extent, depend on how effectively those recommendations are implemented. *According to UNOPS, the final draft of the BOA audit report was completed on 29 June 2007 and officially published in mid-August 2007. Given the recency of these BOA recommendations, the progress made by UNOPS in implementing them in a relatively short time is indicative of management's serious commitment to their accomplishment.*

11. In 2006 and 2007, UNOPS initiated several major reforms to improve UNOPS operations, including the relocation of UNOPS HQs from New York to Copenhagen, change of managers in key positions, transfer of the internal audit function from UNDP to UNOPS, and a series of reforms in finance, procurement and project management as part of the new strategy developed by the UNOPS management.

12. OIOS also noted that some recommendations addressing shortcomings and control deficiencies had been raised by the BOA in its previous reports on

financial statements of UNOPS. Those included the need for regular and timely reconciliation of accounts, proper presentation and disclosure of financial statements, and appropriate monitoring and evaluation of project income and cost of services. However, the former UNOPS management failed to implement those recommendations, and many of these issues remain to be addressed.

B. Going concern issues

Interfund account receivable

13. The BOA issued a qualified opinion on the financial statements of UNOPS for the period ended 31 December 2005 relating to the amount of \$9.9 million reflected as an interfund account receivable from UNDP. UNOPS has made a provision of \$5 million only against this receivable. UNOPS had a series of meetings and negotiations with UNDP to settle the issue of unreconciled \$9.9 million receivables. However, to date, the issue has not been resolved. UNOPS management explained that they have submitted an official letter to UNDP with a detailed breakdown of the amount and proposals to accept the liability by each party and the UNOPS management is expecting to finalize by December 2007. This issue needs to be urgently settled since it has a direct impact on the operational reserve.

Operational reserve

14. The amount of the operational reserve balance as of 31 December 2006 was reported by UNOPS at \$13.3 million, which is far below the statutory required level of \$30.3 million. The UNOPS management plans to achieve the required level of the operational reserve by the end of 2009. However, the detailed profitability projection was not prepared. There is a need for UNOPS to make a detailed projection of reserve deficit liquidation.

15. *According to UNOPS, given the upcoming introduction of IPSAS as of 1 January 2010, UNOPS management intends to make a major effort in the 2008/2009 biennium to realize full accrual for ASHI liabilities. Against that background and the likelihood of a number of potential write-offs (stemming from operations in 2004/2005 and prior periods), UNOPS will require until the end of the 2010/2011 biennium to replenish operational reserves to mandated levels. UNOPS also stated that detailed projections as to the replenishment of UNOPS' operational reserve would be formalized in the 2008/2009 budget to be completed by mid-November 2007.*

16. In previous biennium 2004-2005, UNOPS made a provision of \$11.9 million for ASHI liability against the total accrued liability of \$41.7 million. The unaccounted accrued liability of \$29.8 million was disclosed in the notes to the financial statements as of 31 December 2005. In 2006, a provision of \$5.9 million was made for that year liability increasing the total provision for ASHI to \$17.8 million. However, UNOPS also reversed \$8.2 million from the accumulated ASHI provision made in previous years. This reversal has decreased the ASHI provision to \$9.6 million, consequently increasing the unaccounted accrued liability for ASHI to \$32.1 million.

17. *According to UNOPS, the Office has, as of 1 January 2004, accrued ASHI liabilities on a current year basis and intends to accrue remaining prior year liabilities to ensure a full accrual is in place no later than December 2009. The reversal transaction mentioned above is both legitimate and justified and has no effect on operational reserves.* OIOS does not agree with the above statement that the reversal transaction was justified, since UNOPS management did not provide OIOS with the documentation explaining the reasons for this transaction.

18. Considering the low level of the operational reserve, which is \$17 million short of the required level, and an unaccounted accrued liability for ASHI amounting to \$32.1 million, in OIOS' opinion, there is a high risk that UNOPS may not be able to continue as a going concern.

19. *According to UNOPS, its current business outlook is the most accurate measure of its capacity to continue as a going concern. UNOPS' financial history reflects the confluence of two key sets of factors: (i) the vision, judgment, and professionalism of a series of senior management teams; and (ii) a unique sequence of real world events. First, without question, serious leadership and managerial misjudgments have diminished UNOPS' historic profitability and consumed its reserves. But since those managers are no longer making UNOPS business decisions, any realistic evaluation of UNOPS' prospects must look at the markets UNOPS serves. Second, the challenge UNOPS faces to replenish its reserve is due to significant, prior year adjustments for extraordinary events, and does not indicate UNOPS ongoing capacity to be a self-financing entity. Additionally, it should be noted that UNOPS' situation concerning ASHI liabilities is better than that of the majority of UN organizations, since UNOPS proactively started accruing ASHI liabilities as of 1 January 2004.* In OIOS' opinion, UNOPS status as a self-financing entity is different compared to UN budget organizations, and the absence of adequate provision for required liabilities has a greater impact on its ability to continue as a going concern.

20. Nonetheless, OIOS noted that during the past fifteen months, the newly appointed senior management of UNOPS made efforts to launch several initiatives and reforms to improve UNOPS activities. As of the end of September 2007, UNOPS exceeded an annual target of the project delivery approved by the Executive Board for the year of 2007 by \$45 million (\$657 million vs. the target of \$612 million). There is an indication that the expansion of UNOPS business will continue. In addition, the Executive Board of UNDP and UNFPA decided to transfer the direct procurement function carried out by UNDP/Inter Agency Procurement Services Office (IAPSO) with respect to common user items to UNOPS, which would strengthen UNOPS as a central procurement resource to the United Nations System. The merger will be effective January 2008 and may contribute to further expansion of UNOPS business.

21. In OIOS' opinion, there is a need for the governing bodies of UNOPS to establish a mechanism for closely monitoring UNOPS operations and the results of the reforms undertaken by UNOPS management in order to improve UNOPS' financial standing and secure its ability to continue as a going concern.

C. Internal controls

Governance and accountability

22. Currently, UNOPS reports through its Management Coordination Committee (MCC) to the Executive Board. The Executive Board reviews issues concerning UNOPS as a UNDP segment, although UNOPS has been a separate entity since 1995. Out of 42 decisions made by the Board in 2005, only a few decisions related to UNOPS (5 out of 37 – in 2006 and 3 out of 30 in 2007)

23. The membership of UNOPS MCC includes top management from UNDP, the Department of Management (DM), the Department of Field Support (DFS), the Department of Economic and Social Affairs (DESA), the International Fund for Agricultural Development (IFAD) and UNOPS. MCC was established to set a proper oversight mechanism and “provide the policy and management direction in the functioning of UNOPS, including the setting of operational policy, facilitation and monitoring of compliance”.¹ At the MCC meeting in June 2007, some members raised the issue of revising the role of MCC and the governance arrangements for UNOPS. Moreover, as stated at the MCC meeting on 8 September 2006, UNOPS governance provisions “were lacking clarity regarding responsibilities and accountabilities”. *UNOPS informed OIOS that at the initiative of the MCC Chair, a governance study for UNOPS had been launched in September 2007 and was in progress.*

24. According to UNOPS, in 2005 and 2006, UNDP updated and refined its risk assessment model for UNOPS operations. However, a comprehensive risk assessment of UNOPS operations has not been done in the past. In OIOS’ opinion, UNOPS management needs to conduct an on-going risk assessment to identify critical areas in UNOPS operations, as well as in the restructuring process and reforms that are currently under way. *In this regard, UNOPS commented that it had included a comprehensive risk-assessment plan as a major responsibility of the newly formed Strategy and Audit Advisory Committee, which should monitor the UNOPS management’s progress against risk mitigation objectives to be established for 2008 and beyond.*

25. The Internal Control Framework for UNOPS Offices issued in October 2005, needs a thorough review and revision in light of changes in organizational structure and decentralized financial management initiated by UNOPS. OIOS noted that some provisions of the framework did not provide for proper segregation of certifying and approving authorities.

26. *UNOPS commented that the updated and expanded Internal Control Framework would be ready for implementation in late November 2007. The final draft has been shared with external consultants for an in-depth independent review and benchmarking against best practices in the private and public sectors. UNOPS further stated that as a general point concerning internal controls, the UNOPS management provided OIOS with numerous recently-*

¹ DP/1994/61

developed updated policies, organizational directives, and operational guidelines, which are an integral part of the process improvement efforts.

Internal audit and audit committee functions

27. Since the start of UNOPS operations in 1995, its internal audit function was carried out by UNDP. The audits were conducted by the Office for Project Services on Internal Audit Services (PSAS) of UNDP's Office of Audit and Performance Review (OAPR). According to UNOPS management, PSAS had from 3 to 5 auditors with 7 authorized posts from 2002 to 2006. During this period, the post of the chief of PSAS had not been filled for three and a half years, and the respective functions were performed by the acting chief. The audits conducted by PSAS focused primarily on individual projects and regional offices operations. UNDP also provided management advisory and investigation services and made some topical reviews related to a specific region or programme. An audit of UNOPS Division of Finance was conducted in 2005. However, there were no comprehensive audits of UNOPS regarding overall management of operations, governance, organizational structures and internal controls framework.

28. OIOS noted that the UNOPS Office of Internal Audit (OIA) was being established with five authorized professional posts. At the time of the review, two posts have been filled. The acting chief of OIA was preparing the audit charter and planned to develop the UNOPS audit manual. UNOPS stated that the Head of Audit (P-5) recruitment had been completed, and the post will be filled in January 2008. The remaining four officers have been selected and offers accepted. One senior auditor (P-4) is already in place in Copenhagen since August 2007, and the other three (all at P-3) are arriving in early to mid-November 2007 (two) through January 2008 (one).

29. UNOPS is also establishing the UNOPS Strategy and Audit Advisory Committee (SAAC), which will have an advisory role with no governance powers. The Committee is expected to have its first meeting by the end of 2007. According to the draft terms of reference for the Committee, it will report to the Executive Director of UNOPS with no access to the Board, and its membership will be renewed annually at the discretion of the UNOPS management. In OIOS' opinion, the proposed arrangement for the UNOPS Strategy and Audit Advisory Committee does not follow best practices for establishing an independent audit committee as part of the governance structure.

30. *UNOPS stated that it strongly disagreed that the newly formed Strategy and Audit Advisory Committee deviated from best practices. The Committee has been established in a completely independent manner and its membership includes very senior industry experts who have served as executives at a broad range of institutions, including a partner at a Big 4 Accounting firm, an Auditor General from a multi-lateral development bank, the former head of a major donor organization, and a current CEO of a European energy company. UNOPS believes that a Committee reporting directly to the Executive Board would not attract this level of important members and would not benefit from the advice from these independent industry leaders. Reporting to the Executive Director of*

UNOPS does not exclude Committee members' access to the Executive Board. UNOPS believes independence and freedom from governance responsibilities are absolute requirements to attract these individuals, in particular on a pro-bono basis. The latter aspect has recently been hailed by the ACABQ as a best practice in the UN system.

31. In OIOS opinion, the annual renewal of the Committee's membership at the discretion of the UNOPS management and reporting to the Executive Director with no access to the Board do not provide for adequate independence of the Committee. Moreover, contrary to UNOPS' statement, the draft terms of reference for SAAC, reviewed by OIOS, did not include the provision that the Committee had access to the Board.

Procurement operations

Evaluation of bids and award of contracts

32. OIOS reviewed the contract award system relating to Mine Action Services provided by UNOPS in support of the United Nations Mission in Sudan (UNMIS). Procurement without competitive bidding was observed in sampled cases. In one case, the amount of the addendum exceeded the original contract amount by 167 per cent. The contract for \$5.9 million was initially awarded to a sole technically qualified bidder after the bidding process. However, the contract was later amended without bidding increasing the contract amount up to \$15.7 millions.

33. *UNOPS stated that as a general point, "procurement without competitive bidding" is not an extraordinary occurrence as one may gather from the above observation. As long as such instances are properly documented and justified through the use of a written waiver, they are in line with UN regulations and rules as well as with the UNOPS procurement manual. Waivers of competitive bidding are more prevalent in the crisis and post-conflict areas due to very few available suppliers and extraordinarily challenging deadlines for completion of procurement exercises.*

34. *UNOPS further stated that the solicitation process conducted in May 2005 had the explicit goal of establishing contracts for up to two years for the services of route verification teams for any project worldwide. The result of this tender was that the sole technically qualified bidder initially received a one-year contract for Sudan, with the option (as per the RFP) for UNOPS to extend the contract for a further year. At the time of the contract extension, a review of the cost and performance of the contractor took place. Following the above comprehensive review and the original scope of the RFP to provide two-year capacity for route verification, UNOPS Procurement Review and Acceptance Committee (PRAC) recommended, and the Chief Procurement Officer approved, a waiver to extend the contract for a second year (July 2006 to June 2007), bringing the total contract amount to \$15.7 million. Thus, the amendment was part of the original scope of the RFP, but since the full scope was only contracted in 2005, technically the subsequent addition to bring the contract to full scope was treated as a waiver.*

35. OIOS is of the opinion that there is a need for UNOPS to improve the procurement process to avoid the use of waivers of competitive bidding. The initial contract, referred to in paragraph 32 and commented on by UNOPS, was approved by the PRAC with no option to extend, and the contract did not include the provision for the option. Moreover, at the time of the award of the initial contract, the PRAC recommended that “the Submitting Unit expand on the market research done through the Expression of Interest process by conducting the prequalification exercise well in time prior to the expiration of the contract to be awarded so as to better map out actual capacities existing in the market.” In this regard, OIOS considers UNOPS comments about the justification of the contract extension without bidding as irrelevant, as the prequalification exercise recommended by the PRAC had not been done.

36. According to UNOPS’ Procurement Manual, the Office uses a cumulative analysis of bids in cases where a Request for Proposals (RFP) is issued. The technical part of the proposal is assessed using a 100 point scale, and a 25 point scale for the financial evaluation. The bidders must secure at least 75 points in the technical evaluation of the proposal to be qualified for further financial evaluation. In some cases, the second highest scorer quoted a significantly lower amount, although the difference in the evaluation score versus the winner’s score was insignificant. In one case, the difference in the evaluation score was less than 0.1 point, but the contract was awarded to the vendor whose bid was higher by \$1.1 million. Similarly, in another case, the difference in the evaluation score was 1.93 points, but the contract was awarded to the vendor whose bid was higher by \$2.3 million.

37. *Commenting on the above observation, UNOPS stated that it strictly adhered to the principle of best value for money for its procurement activities and referred to the provisions of UNOPS Procurement Manual Chapter 6 - Evaluation.*

38. *UNOPS further stated that the two envelope system avoids tampering with point allocations to obtain a specific result. The technical points are, therefore, allotted before the financial offers are opened, and the inclusion of the financial offer is a straightforward exercise. Under no circumstances may the scoring subsequently change, nor is it acceptable to ignore the end result of the evaluation, no matter how marginal a point difference is. Such considerations would be unfair and would result in lack of transparency. In those cases mentioned by OIOS where contractors bid lower amounts but had weaker technical offers, the savings involved even when substantial did not outweigh the risk of the lack of technical competence, safety, and feasibility of meeting the client’s needs.*

39. OIOS does not agree with UNOPS’ comments. Rule 114.22 (b) of UNOPS Financial Regulations states “when request for proposals have been issued in accordance with Rule 114.20 (b), contracts shall be awarded to the qualified contractor whose proposal is considered to be the most responsive to the need of UNOPS and activity concerned, due consideration should be given to the general principles described in Rule 114.18.” Describing the general

principles, Rule 114.18 indicates the first principle as “Economy and efficiency”. In OIOS’ opinion, the principle of economy was not properly considered by UNOPS in those reviewed cases, where the difference in the evaluation score was minimal (difference of 0.5 to 2.00 points) but the potential cost saving would have been over one million dollars.

40. In one case, the PRAC had approved an amendment to the contract after the services had been already provided by the vendor. The amendment for \$3.1 million was processed in order to extend the contract period and to deploy additional three assistant team leaders to work as part of Route Clearance Teams (RCT), two dog handlers to work as part of RCT for Group 1 and Group 2 and one engineer. The amendment was retroactively approved by PRAC on 15 May 2006 effective from 1 March 2006 through 30 June 2007. According to UNOPS, there was a delay on the part of the project manager in submitting the case for the review.

41. *UNOPS stated that as correctly noted by OIOS, there was a delay in submitting an amendment for the Committee’s review and CPO approval, which was handled retroactively. PRAC found the rates applied reasonable, and, therefore, no financial loss occurred to the Organization. The committee noted, however, that the submitting officer should have brought the case for review immediately to comply with UNOPS internal procedures.*

Price negotiation after contract award

42. In some cases, UNOPS solicited bids for various separate packages of services, and vendors submitted bids for more than one package of services. Each bid was separately evaluated, and the contract was recommended for award based on the highest score derived from the bid evaluation. According to UNOPS, the price of awarded contracts in such cases was further reduced through negotiation with the winner. The recommendation on award of the contract was reviewed by the PRAC and, since January 2007, by the Headquarters Contracts and Property Committee (HQPC), and approved by the Chief Procurement Officer/Deputy Executive Director.

43. The UNOPS North America Office (NAO) had negotiated with the vendors for mine action services in Sudan after the award of the contract. According to UNOPS, the price negotiation with the contractor was made in a situation where: (i) a contractor was awarded more than one package resulting in lower management cost; (ii) a previous contractor was awarded a new contract, thus, not bearing the demobilization cost for a previous contract and the mobilization cost for a new contract; and (iii) there were changes in contract inputs on the part of the vendor. There were no minutes reflecting the negotiations to reduce the approved amounts of contracts, and showing the breakdown of the reduced costs. After the negotiation, the final amounts were not reported to the contract committee.

44. *UNOPS commented that although there were no single consolidated minutes on negotiations held in the specific situations mentioned by OIOS, all details regarding items negotiated and corresponding follow-up with the*

contractors were documented in e-mail exchanges. UNOPS has since improved its documentation of negotiations with suppliers. Subsequent tenders for the 2007/2008 Assessed Budget will include documented summaries of the negotiations, and the HQPC will be informed of negotiation results and consequent cost reductions, based on final contractor costing details after signature of the Memorandum of Agreement between the UN and UNOPS.

UNMAS involvement in the procurement process

45. Annex II of the Memorandums of Agreement (MOA) signed for the periods of 2006/2007 and 2007/2008 defined the responsibilities of UNOPS and the United Nations Mine Action Services (UNMAS) of the Department of Peacekeeping Operations. According to the MOA, UNMAS was responsible to provide concurrence/approval for a short list of selected vendors to be invited for the participation in the bidding. UNMAS staff was involved in the procurement process (bid opening, bid evaluation). However, these responsibilities were not documented in the reviewed procedures or any other documents.

46. *UNOPS management commented that, as per UNOPS Procurement Manual section 6.4.1, stakeholders may participate in the evaluation as observers. Thus, although UNMAS' involvement in the procurement process is not formally documented, UNMAS members were involved in the evaluation process as observers in order to ensure transparency and give technical input where necessary.* In OIOS' opinion, UNOPS' statement is partially correct, as the documentation reviewed showed that some UNMAS personnel had served as members of the UNOPS evaluation panel performing procurement functions, and not as observers.

47. According to UNMAS, Annex II of MOA effective July 2007 for trust fund projects included actual roles performed by UNMAS, Field Offices and UNOPS in the procurement process. However, the Annex did not indicate UNMAS' involvement in bid opening and bid evaluation. UNMAS agreed that Annex II needs to be revised to clarify the responsibilities of the parties involved in the UNOPS procurement process. OIOS was also advised that the new Annex for projects in peacekeeping operations will be effective January 2008, when the MOA will be extended for the remaining period of the financial year 2007/2008.

48. In OIOS' opinion, to ensure transparency and accountability in procurement operations, UNMAS' roles and responsibilities in the procurement process related to UNOPS projects need to be clearly established and formalized in respective manuals or procedures.

49. *As a general point with regard to OIOS' observations on procurement, UNOPS stated that OIOS had offered only minor observations on a few specific procurement cases, without a full understanding of the procurement process followed, instead of concentrating on the general state of internal controls in UNOPS procurement. UNOPS further stated that it had put in place a robust system of checks and balances, including a well-functioning contracts committee and subsequent review by the Chief Procurement Officer, procurement training*

for staff and a procurement manual, and that these practices provided fairness, transparency and best value for money in UNOPS procurement.

50. OIOS disagrees with the above statement, as the review was focused on the assessment of internal controls, and had also acknowledged the existence of the UNOPS contract committee and the procurement manual. Rather, OIOS testing of procurement cases involving the major contracts funded from the UN peacekeeping budget raised the issues of economy in UNOPS procurement operations. It should be also reiterated that OIOS conducted a review, not a full-fledged audit, within a limited time frame, and thus the observations were based on its review of sampled procurement cases. OIOS reiterates its view that there is a need for UNOPS to improve the procurement process to avoid the use of waivers of competitive bidding.

Financial controls and maintenance of accounting records

51. UNOPS management has taken initiatives to improve the financial management by strengthening the finance function, including the hiring of new staff for the Office of Finance at UNOPS Headquarters and in the regional offices. The new Finance Director and the Comptroller were recruited in February 2007 and August 2007 respectively.

Reconciliation of accounts

52. In July 2006, UNOPS hired the firm of Deloitte & Touche for \$1.5 million to assist them in reconciling receivables and other accounts, as there was a considerable backlog in unreconciled items from the prior periods.

53. However, UNOPS still have difficulties to reconcile accounts and process all transactions in a timely manner, which leads to incomplete and inaccurate accounting records. For example, there was a \$3.6 million difference in UNDP (\$1,067,703.24) and UNOPS records (\$4,630,137.55) on the JP Morgan Chase bank account balance as of 31 December 2006. The results of the reconciliation of this account, which was done by UNDP in April 2007, were not verified by UNOPS at the time of preparing financial statements of 2006. The difference in records was revealed by the UNOPS Finance Section only in September 2007, when OIOS asked UNOPS to provide bank reconciliations for the review. By the end of the review at UNOPS Headquarters, the Finance Section was still following up with UNDP, which provides a treasury function for UNOPS, to obtain a detailed clarification about the reason for the variance in accounting records.

54. *UNOPS stated that in early October 2007, UNOPS identified double counting of cash receipts worth over \$4 million, which were entered by UNDP and are currently being researched by the UNDP Treasury in NY. This amount accounted for the vast majority of the difference. UNOPS also identified a transaction posted by UNDP in 2004 for almost \$1 million, which is currently being examined by UNDP and may account for the remaining difference. UNOPS and UNDP continue to work closely together to ensure that these discrepancies are cleared and reconciled as part of the biennium close process.*

55. Imprest accounts transactions were not recorded in the Atlas accounting system in a timely manner, resulting in incomplete accounting records. UNOPS provided a detailed summary of the difference between data in the Atlas system and records in UNOPS cash books on imprest accounts, as indicated in Table 1. There were also other unprocessed transactions from the prior months of the year, which were not provided to OIOS.

Table 1: Difference in records on imprest accounts transactions

Month	Total balance per imprest cash book (USD)	Total balance of imprest accounts in the Atlas system (USD)	Difference (USD)
June 2007	15,411,094	13,607,063	1,804,031
July 2007	14,340,298	9,921,590	4,418,708
August 2007	12,595,006	4,730,047	7,864,959
Total	42,346,398	28,258,700	14,087,698

56. OIOS also noticed an \$112,440.74 difference in the cash balance shown in UNOPS financial statements as of 31 December 2006 (\$16,023,605.24) and in the imprest cash book (\$16,136,045.98). According to UNOPS, the variance of \$112,440.74 was the net effect of several transactions (Debit/Credit). The transactions have been identified by the UNOPS Finance Section and will be adjusted in the accounting records by the end of November 2007.

57. UNOPS also advised OIOS that a dedicated and focused “imprest team” established in New York would reconcile the accounts for the period from January to July 2007. OIOS further noted that, effective August 2007, the function of imprest processing was transferred to the regional offices of UNOPS. The reconciliation of imprest accounts from August to December 2007 will be done by the regional “imprest team” on a regular basis with oversight provided by UNOPS Headquarters. According to UNOPS, manual imprest processing will be discontinued for all projects in locations where the Atlas system is available. As a pilot project, it was successfully done in Afghanistan in August 2007. By March 2008, recording of 70 to 80 per cent of the current imprest transactions is planned to be processed using the Atlas system. *UNOPS stated that the imprest reconciliation would be finalized prior to the biennium closing process*

Inactive Accounts Receivable

58. UNOPS does not monitor the aging of receivables. As shown in Table 2, long-outstanding receivable items identified by BOA during the audit UNOPS financial statements for the biennium ending 31 December 2005 were still not settled in the following accounts: *UNOPS stated that it would complete all necessary reconciliations and make proper adjustments for all doubtful accounts receivable items as part of the biennium closing process.*

Table 2: Long-outstanding items in accounts receivable

Account number	Account name	USD
21005	Accounts payable(Debit balances)	481,387
23010	MIP contributions (Debit balance)	49,904
23045	Appendix D other experts	62,767
14080	Misc. Receivable	466,975
14060	Receivable within one year	913,000
14040	Staff receivable	88,779

Access control

59. OIOS noted weaknesses in access control to the Atlas accounting system. Some managers with operational level of access were not deleted from the system users list for months after their separation from UNOPS.

Table 3: Delays in deleting the access to Atlas for separated staff

Name	Contract expiration date	Date of the request for deleting the user ID from the system	Date when Atlas User ID was deleted from the system	Number of days from the contract expiration date to the date the User ID was deleted
David Rendall	31 Dec 2006	20 Sept 2007	21 Sept 2007	265
Farnaz Shemirani	30 June 2007	21 Sept 2007	24 Sept 2007	86

60. *UNOPS stated that it had put in place a procedure whereby the UNOPS Atlas Helpdesk runs a weekly report that displays the names of staff who separated from the organization. Prompt action is taken to delete such account. As a medium to long-term solution, UNOPS and UNDP are collaborating on a 'Federation' project whereby ATLAS user accounts will be automatically deleted upon contract expiration.*

Financial statements

61. UNOPS prepared draft financial statements for the year ended 31 December 2006. The financial statements were signed by the Finance Director only. The cash flow statement, the project expenditure and support costs statement, the notes to the financial statements were not prepared. The UNOPS management explained that they prepared the statements and notes to the financial statements only at the end of the biennium. However, the Executive Board for UNDP and UNFPA instructed UNOPS to submit an annual report including financial statements at every annual session of the Executive Board (DP/2007/16).

62. *UNOPS stated that it prepared "interim 2006 financial statements" solely for internal management purposes. These results were neither published nor final. The UNOPS Director of Finance, on an exceptional basis, endorsed*

the statements as accurate to the best of his knowledge, on a single occasion as part of required documentation for a proposal for one project with the European Commission. UNOPS does not agree that detailed notes to unaudited, interim statements are required. However, UNOPS fully agrees that it would be helpful to include a brief narrative for mid-biennium financial statements as a management tool.

63. OIOS is of the opinion that in the absence of notes to interim financial statements, the users of the statements would not have detailed information on the accounting policies followed, provisions made, and other information required to be disclosed in the financial statements. For example, when OIOS inquired about the basis for a reversal of the \$8.2 million provision for ASHI liabilities, which decreased the corresponding amount shown in the audited financial statements for the biennium 2004-2005, there was no documented management trail of this transaction. UNOPS management had to contact the former finance director to obtain information regarding this transaction. OIOS was not provided with an explanation or supporting documentation for the \$8.2 million reversal of the ASHI provision at the time of the review.

Project implementation

Memorandum of Agreement and installment payments

64. There were delays in signing MOAs for mine action services. For example, on 19 October 2006, the UN and UNOPS signed an MOA for \$38.8 million for the mine action support of UNMIS effective from 1 July 2006 to 30 June 2007. The MOA had a provision that the first installment of \$17.6 million for the period from July to September 2006 would be paid to UNOPS promptly upon signing the agreement. The UN made the first installment payment only on 1 March 2007, nine months after the commencement of the project period and 132 days after signing the agreement.

65. According to UNOPS, in many cases, there was a considerable delay in signing MOAs and in the disbursement of funds by the UN. The UNOPS policy and the provision of MOA require that the funds should be made available for UNOPS in advance. However, there were a number of instances where the UN requested UNOPS to execute the project, although an MOA was not signed and the initial installment payment could not be made to UNOPS. As a result, UNOPS had to provide advance funding for those projects. *In this regard, UNOPS stated that the UN had requested the Office to provide advance funding for \$107.8 million under 32 projects. If “closed” and “pending” projects (i.e. “processed” projects) are excluded, then the total outstanding amount decreases to \$63.2 million relating to 12 projects.*

66. UNMAS further stated that one of the reasons for the delay in installment payments was UNOPS' inability to submit quarterly/yearly financial statements for the projects or to provide necessary information requested by UNMAS. For example, to receive the installment payments for the project concerning the mine action support in Sudan, UNMAS had to make several follow ups in requesting UNOPS to submit 2005/2006 financial statements. The first and second

installments for the project to be implemented in 2006/2007 were put on hold due to UNOPS' non-submission of financial statements for the project in the previous financial year 2005/2006. The statements were submitted only in February 2007. In another case, the financial statements for the first and second quarters of 2006/2007, which were due for submission on 31 October 2006 and 31 January 2007 respectively, were provided to UNMAS in a consolidated form for both quarters only on 8 May 2007.

67. *According to UNOPS, the late submission of the final financial report for the 2005/06 Sudan project was due to, among other factors, a delay in the liquidation of purchase orders, changes in UNOPS finance personnel, and relocation of the organization's financial section from New York to Copenhagen. One particularly large purchase order for procurement of metal detectors for demining remained unliquidated for a long period due to late arrival of the equipment; it was impossible to collect payment before the arrival and verification of the equipment. UNOPS produced several 'interim-final' reports to UNMAS to explain the delayed issuance of the final certified financial report.*

68. *UNOPS further stated that to avoid such delays in future, NAO recruited a dedicated finance assistant to ensure timely reporting, and all recent reports have been submitted on time. Furthermore, UNOPS and UNMAS are holding a joint quarterly financial review meeting to identify potential irregularities concerning project expenditure and take any necessary action. Both parties recognize that the requirement for a final financial report within three months, as stipulated in the 2005/06 MOA, was unreasonable. This has been reviewed for the 2006/07 MOA and revised to six months.*

69. *UNOPS also stated that the 2006/07 MOA did not stipulate the previous year financial report as a pre-condition for the first payment. Furthermore, the initial payment for the 2006/07 MOA was to have been made upon a signature expected by 1 July 2006, while the deadline for the final financial report for the 2005/06 MOA was 30 September 2006 (within three months of the project completion).*

70. UNMAS officials agreed that there were delays in signing MOAs due to a time consuming process related to the budget allocation for the projects, and also some delays in disbursement of installments due to additional time needed to clarify the queries raised during the payment process. In UNMAS' opinion, the payment cycle is also lengthy, since UNMAS has not been recognized as a separate cost center (though managing a \$130 million budget annually), and the Service has to request funds for installment payment through the Field Budget and Finance Division (FBFD) of the Department of Field Support (DFS).

71. Consideration should be given to assigning UNMAS a separate cost center in order to reduce the lead time in processing installment payments by eliminating the need to request funds through DFS. In addition, a timeline within which the initial installment payment should be made to UNOPS needs to be defined.

UNOPS management fee

72. Generally, UNOPS charges up to ten (10) per cent of programme expenditures as its management fee for the communication and IT service projects with the UN. In the financial year 2006/2007, UNOPS' fee for the mine action projects funded by the UN was usually eight per cent of the programme expenditures. Effective July 2007, the level of the fee was set at five per cent plus the three per cent limit for travel and miscellaneous expenditures actually incurred. However, the Memorandum of Agreement (MOA) did not specify the types of miscellaneous expenditures, and whether prior approval/concurrence of UNMAS was needed to claim such expenditures. According to UNMAS, UNOPS has yet to submit the cost breakdown to justify the level of management fee being charged by UNOPS.

73. *According to UNOPS, the average overhead rate for this type of project is currently in the area of seven (7) to eight (8) per cent. UNOPS also stated that the Office is currently finalizing its itemized list and respective estimates for the agreed "up to 3% direct charges" for further discussions with UNMAS.*

74. OIOS also noted that UNMAS did not use any industry benchmarks to assess the reasonableness of the management fee charged by UNOPS. In order to assess the appropriateness of UNOPS management fees, OIOS believes there is a need to conduct market research in the area of project administration practices and to maintain a database to accumulate data on vendors, their administration fees and other competitive information related to the support and implementation of projects.

Monitoring of project implementation

75. UNOPS improved the monitoring of project implementation by introducing in September 2006 an IT system known as Dashboard. The system appears to be an effective financial management tool in monitoring expenditures and assessing the outputs and status of project implementation in the regions.

Review of project financial statements

76. The cost of project service indicated in MOA is an estimated amount. UNOPS charges the cost of project service based on actual expenditures incurred during the implementation of projects plus the administrative fee. It is a general practice that the funding agencies make a requirement that the entity implementing the projects submit to the donors the audit reports for large projects, in order to provide assurance to the donors that (i) agreement provisions were complied with; (ii) expenditures were properly charged; and (iii) internal controls were in place. However, OIOS found that there was no such requirement in MOA between the United Nations Secretariat and UNOPS.

77. UNOPS submits quarterly/yearly financial statements showing total expenditures for personnel, travel, contract services, equipment and other costs. UNOPS provides additional information only at the request of UNMAS, if any.

In OIOS' opinion, there is a risk that certain overhead costs may be improperly charged to the project accounts, which will also increase the management fee.

78. Considering that the value of the projects implemented by UNOPS exceeds \$120 million, OIOS believes there is a need for UNMAS to establish and formalize a proper accountability mechanism to obtain assurance that project expenditures and the UNOPS management fees are properly charged.

V. ACKNOWLEDGEMENT

79. We wish to express our appreciation to the management and staff of UNOPS for the assistance and cooperation extended to the review team during this assignment.

UNITED NATIONS



OIOS Client Satisfaction Survey

Audit of: Actions taken to strengthen financial management and the internal control system in the United Nations Office for Project Services (AP2007/850/01)

	1	2	3	4	5
By checking the appropriate box, please rate:	Very Poor	Poor	Satisfactory	Good	Excellent
1. The extent to which the audit addressed your concerns as a manager.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The audit staff's understanding of your operations and objectives.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Professionalism of the audit staff (demeanour, communication and responsiveness).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. The quality of the Audit Report in terms of:					
• Accuracy and validity of findings and conclusions;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Clarity and conciseness;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Balance and objectivity;	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Timeliness.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. The extent to which the audit recommendations were appropriate and helpful.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. The extent to which the auditors considered your comments.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Your overall satisfaction with the conduct of the audit and its results.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please add any further comments you may have on the audit process to let us know what we are doing well and what can be improved.

Name: _____ Title: _____ Date: _____

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