UNITED NATIONS DEVELOPMENT PROGRAMME
Office of Audit and Investigations

AUDIT

OF

UNDP OFFICE

IN

CROATIA

Report No. 1325

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Report on the audit of UNDP Croatia
Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of UNDP Croatia (the Office) from 19 to 30 May 2014. The audit aimed to assess the adequacy and effectiveness of the governance, risk management and control processes relating to the following areas and sub-areas:

(a) governance and strategic management (organizational structure and delegations of authority, leadership/ethics and values, risk management, planning, monitoring and reporting, financial sustainability);

(b) United Nations system coordination (development activities, Resident Coordinator Office);

(c) programme activities (programme management, partnerships and resource mobilization, project management); and

(d) operations (human resources, finance, procurement, information and communication technology, general administration, safety and security, asset management, leave management).

The audit aimed to assist management with its transition from a Country Office to a Project Management Office by identifying and proposing ways to address any unresolved issues.

The audit covered the activities of the Office from 1 January 2013 to 31 March 2014 with programme and management expenditures totalling $6.6 million. The last audit of the Office was conducted by OAI in 2010.

The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Overall audit rating

OAI assessed the Office as **satisfactory,** which means, "Internal controls, governance and risk management processes were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity."

Key recommendation: Total = **1,** high priority = **0**

The audit did not result in any high (critical) priority recommendations. There is one medium (important) priority recommendation, which means, "Action is required to ensure that UNDP is not exposed to risks that are considered moderate. Failure to take action could contribute to negative consequences for UNDP." This recommendation includes actions to finalize the transition to the Project Management Office.

Management comments and action plan

The Head of Office accepted the recommendation and is in the process of implementing it. Comments and/or additional information provided had been incorporated in the report, where appropriate.

Issues with less significance (not included in this report) have been discussed directly with management and actions have been initiated to address them.

Antoine Khoury
Officer-in-Charge
Office of Audit and Investigations

I.   About the Office

The Office, located in Zagreb, Croatia (the Country) was established in 1996 as a liaison office and was upgraded to a Country Office in 2001. The latest Office programming was based on a 'Country Programme Document' covering the period from 2007 to 2013. In 2014, the Country graduated to Net Contributor Country status and its eligibility for core funding came to an end. The Office's planned transition to a Project Management Office as of 1 July 2014 was based on a request from the Government for continued UNDP support, mainly in the areas of: (a) environment and energy; (b) regional/rural development; and (c) social inclusion.

II.   Audit results

Satisfactory performance was noted in the following areas:

(a) <u>United Nations system coordination</u>. The United Nations Country Team consisted of IOM, UNDP, UNICEF, UNHCR, World Bank, and WHO. The agencies under the leadership of the Resident Coordinator were conducting limited joint activities. No reportable issues were noted.

(b) <u>Programme activities</u>. The review of the programme activities that were based on the 'Country Programme Document' for 2007-2013 and the reviews of project management did not result in any reportable issues. The last programming cycle, which ended in 2013, produced positive results, as indicated in the 'Assessment of Development Results' report issued by the Independent Evaluation Office in February 2014.

(c) <u>Operations (excluding human resources)</u>. No reportable issues were identified concerning procurement, general administration, information and communication technology, and safety and security. Supporting documentation on financial and operational matters were properly kept and classified in an orderly manner to facilitate the Office's day to day work. Information and communication technology managed by the Office, including hardware, software, systems security, and disaster recovery mechanisms were adequately operating.

OAI made one recommendation ranked medium (important) priority.

Low priority issues/recommendations were discussed directly and agreed with the Office and are not included in this report.

Medium priority recommendation:

▪   Finalize the Office's transition plan (Recommendation 1).

The detailed assessment is presented below, per audit area:

A. Governance and strategic management

1. Organizational structure and delegations of authority

Issue 1   Pending actions relating to transition plan

The Office prepared its transition plan with a view of shifting to a non-core environment as of 1 January 2014 and formally establishing the Project Management Office as of 1 July 2014. At the Government's request, the Resident Representative and the Assistant Resident Representative were to continue carrying out their functions until 30 June 2014, when a new Head of Office was to be appointed. The transition plan approved by the Regional Bureau for Europe and the Commonwealth of Independent States was planned to take effect by 30 June 2014. OAI identified the following points in the plan that were not fully resolved at the time of audit:

(a) Internal Control Framework
     The Resident Representative issued a memo defining the management arrangement in place during the transition period (until 30 June 2014). The Office prepared a table with the list of staff, their existing functions and their Atlas (the enterprise resource planning system used by UNDP) access rights during the transition period. However, the internal control framework that was to be used after 30 June 2014 was still a work-in-progress. According to management, the framework was expected to be completed by 31 July 2014.

     Not having an internal control framework may lead to weak internal controls and the improper segregation of duties.

(b) Service contract used for Finance and Administration Associate
     During the transition, the Office decreased the number of core staff from 17 to 6, keeping only the functions necessary for the Office to operate after 1 July 2014. Taking into account the limited funds, the Office used the service contract modality to engage the Finance and Administration Associate, which is considered one of the Office's core functions, and granted her the same Atlas approving rights granted to UNDP staff. The Office explained that this arrangement was reported to the Regional Bureau as part of the discussions on the transition plan.

     The hiring of service contractors limits the Office's ability to adequately segregate duties because they cannot exercise the same Atlas approving rights as UNDP staff.

(c) Budget override policy
     According to the UNDP 'Risk Management Guidelines', the budget override policy should be documented and approved by the Office of Financial Resources Management. There were 13 cases of budget overrides during the audit period amounting to $150,000 (or 2.3 percent of all payments) due to delays in receiving funds from donors. These overrides were authorized by the Resident Representative. The funds were ultimately received from the donors.

     The Office had also not finalized a detailed override policy approved by the Office of Financial Resources Management in accordance with the Guidelines, taking into account changes in the Office's management after 1 July 2014.

Without a written policy clarifying the different steps that should be carried out for the approval of an override, the Office may inappropriately exercise this authority without having documented the assessment of the financial risks involved as well as the corresponding mitigating measures.

(d) <u>Office premises</u>
The Office's premises are covered by a lease agreement between the Government and a private owner of the building. The Government informed UNDP in writing in July 2013 that it would provide premises at no cost with the provision that the United Nations agencies pay for utilities. A letter of agreement between UNDP and the Government relating to the in-kind Government Contribution to Local Office Cost through the provision of office premises expired on 15 December 2012. An agreement between UNDP and the Government to outline the details for the current period is in the process of being formalized. The Office expects this to be resolved by the end of September 2014.

The absence of a letter of agreement between UNDP and the Government outlining the details of the Government provision of the Office premises could lead to misunderstandings and possible tension in the relationship between the two parties.

(e) <u>Arrears in the Government Contribution to Local Office Costs</u>
In accordance with the provisions of the Standard Basic Assistance Agreements that govern UNDP operations in programme countries, host governments are expected to contribute towards the cost of Country Offices. Widely known as the Government Contribution to Local Office Costs, the contributions are calculated on an annual basis taking into account actual UNDP operating and staffing costs. The contribution has monetary (cash) and non-monetary (in-kind) components. The amount to be paid is adjusted based on the country's economic development category. Between 2008 and 2013, the Government provided only in-kind Government Contribution to Local Office Costs through provision of office premises, leaving the in-cash contribution of $2.8 million unpaid for the period between 2008 and 2013. It should be noted that the Government covered more than half of UNDP programme expenditures during this time. Part of the Government Contribution to Local Office Costs arrears can be recovered over time through the Government's formal commitment to fund United Nations agencies premises in the future. Further, the Office stated that more innovative courses may need to be pursued, using the new flexibility to convert Government Contribution to Local Office Costs arrears into programme funding.

Outstanding obligations not met by the Government decrease the amount of available funds that could be used by UNDP in the implementation of its development programmes.

Priority	Medium (Important)

Recommendation 1:
 	
Finalize the Office's transition plan by resolving the following points, taking into account the new management structure of the Project Management Office from 1 July 2014:
 	
    (a) Update the internal control framework using the operational guide as published in the UNDP 'Programme and Operations Policies and Procedures'.
 	
    (b) Consult with the Regional Bureau on either the conversion of the position of Finance and Administration Associate to a fixed-term appointment, or the review of the Atlas access rights granted to the service contract holder.	

(c) Finalize the budget override policy, clearly defining the approval authority of the Head of Office and seek its approval from Office of Financial Resources Management.

(d) Follow up with the Government to receive a letter confirming the arrangement for the United Nations agencies for the provision of office premises.

(e) Follow up with the Government to settle the Government Contribution to Local Office Costs arrears.

Management action plan:

All recommendations were discussed with the audit team and are accepted, with the following timetable:

(a) A draft of an internal control framework specifically tailored to the new Project Management Office was already in circulation in June, with the final version to be completed by 31 July 2014.
(b) Consultations on the conversion of the Finance/Administration Associate position with the Regional Bureau will be completed and, if the Office's financial position allows, recruitment on a fixed-term appointment launched by 31 December 2014. The assumptions underlying the approved office transition plan suggest that the creation of any new fixed-term appointment may need to be counterbalanced by the phasing out of one of the other remaining fixed-term appointment positions, or by making other significant cost reductions.
(c) A budget override policy will be submitted to the Office of Financial Resources Management for approval by 31 July 2014.
(d) Negotiations with the Government on the written confirmation of an earlier agreement that United Nations agencies cover utility costs for premises provided free of charge were initiated in November 2013. A resolution is expected by end-September 2014.
(e) A proposal to the Government, to be pursued by the Regional Bureau through the Mission in New York, will be developed in consultation with the Office in Zagreb on converting the Government Contribution to Local Office Costs arrears to programme funding, including funding for programmes implemented in other countries as part of the Country's official development assistance commitments by end-September 2014.

Estimated completion date: For specific deadlines, see dates above.

B. Operations

1. Human resources

Issue 2 <u>Exceptions in the recruitment of service contracts</u>

Five principles guide the recruitment and selection of UNDP staff members and project personnel: competition, objectivity, transparency, diversity and accountability. OAI reviewed 8 service contract recruitments out of 32 recruitments and noted the following in four cases:

- Four former staff holding fixed-term appointments, whose positions were phased out at the end of 2013 as part of the transition process (one long-serving staff, who was separated, and three others

whose contracts were allowed to expire), were later recruited as service contractors with no competitive selection process. According to the 'Service Contract User Guide', a staff member separated for abolition of post or reduction in posts cannot be offered a service contract with the same functions he/she occupied before separation. The Office explained that this process was carried out to maintain consistency in the management of the projects that would end during 2014, after the transition of the Office.

- For two of the service contractors whose fixed-term appointments were allowed to expire, the Office did not observe the minimum break in service of three months (or one month if notice period served).

- The Office prepared 'Notes to File' documenting the rationale for the exceptions and mitigating measures to manage any accompanying risks, but did not seek the approval of the Regional Bureau or the Office of Human Resources for these non-standard arrangements.

Non-compliance with recruitment policies and procedures for service contracts may increase the risks of non-transparent and unfair selection processes that could lead to the most suitable candidates not being selected.

Comment

The Office, in response to the draft report, informed the Regional Bureau and the Office of Human Resources about the recruitments related to the four directly appointed service contractors. One of the four service contracts expired at the end of June 2014, and the other three are set to expire at the end of October 2014. Therefore, OAI is not raising any further recommendation.

Definitions of audit terms - ratings and priorities

A.   AUDIT RATINGS

- **Satisfactory**   Internal controls, governance and risk management processes were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.

- **Partially Satisfactory**   Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.

- **Unsatisfactory**   Internal controls, governance and risk management processes were either not established or not functioning well. The issues were such that the achievement of the overall objectives of the audited entity could be seriously compromised.

B.   PRIORITIES OF AUDIT RECOMMENDATIONS

- **High (Critical)**   Prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP.

- **Medium (Important)**   Action is required to ensure that UNDP is not exposed to risks that are considered moderate. Failure to take action could contribute to negative consequences for UNDP.

- **Low**   Action is desirable and should result in enhanced control or better value for money. Low priority recommendations, if any, are dealt with by the audit team directly with the Office management, either during the exit meeting or through a separate memo subsequent to the fieldwork. Therefore, low priority recommendations are not included in this report.