UNITED NATIONS DEVELOPMENT PROGRAMME
Office of Audit and Investigations

AUDIT

OF THE

UNDP FINANCIAL SUSTAINABILITY

AND

EFFECTIVENESS EXERCISE

Report No. 1601

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Report on the Audit of UNDP Financial Sustainability and Effectiveness Exercise
Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of the UNDP Financial Sustainability and Effectiveness exercise (FSE exercise) from 29 February to 5 May 2016. The audit aimed to assess the adequacy and effectiveness of the governance, risk management and control processes relating to the following areas:

(a) Scope and governance of the FSE exercise

(b) Methodology of the FSE exercise

(c) Results of the FSE exercise

The audit objectives were the following:

1. The extent to which the FSE exercise was designed, implemented and monitored, in line with relevant policies and requirements.
2. Whether Regional Bureaux played the envisaged role in conducting the FSE exercise, including planning, communicating with Country Offices, providing support throughout the process, and receiving, analysing and disseminating the results and outcomes of the FSE exercise.
3. The extent to which the objectives of the FSE exercise were met in relation to the overall budget reductions achieved, as well as their impact on the following areas: (i) clustering of 'back office functions'; (ii) measures taken to improve key functions, especially monitoring and evaluation; and (iii) Country Office presence.

The audit covered the activities of the FSE exercise from 1 January 2013 to 31 March 2016. The audit scope did not include a review of staff separations resulting from the FSE exercise.

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

Overall audit rating

OAI assessed the UNDP FSE exercise 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."

The rating was based on the OAI conclusion that overall, the FSE exercise was conducted in line with the relevant policies and requirements and was effective in reviewing the financial sustainability of Country Offices. The Regional Bureaux played an integral role in planning the FSE exercise and supporting Country Offices throughout the exercise and prepared consolidated plans that met the target budget reductions set out by the Bureau for Management Services (formerly Bureau of Management).

There were some challenges noted in the change management policy of FSE exercise.

Key recommendations: 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 address weaknesses in the change management policy.

The recommendation aims to ensure the following: (a) achievement of the organization's strategic objectives; and (b) effectiveness and efficiency of operations.

Management comments and action plan

The Director of the Bureau for Management Services 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.

Helge S. Osttveiten
Director
Office of Audit and Investigations

I. About the FSE exercise

The FSE exercise was launched in June 2013. The aim was to ensure that Country Offices were equipped to operate effectively and efficiently within the available budget envelope and were fit for purpose in terms of capacity. The FSE exercise was built around the on initial discussions at the Regional Bureau and Country Office levels in early 2013 to address the reduction in the core institutional budget and to capture steps taken by Country Offices to reduce expenditures. The FSE exercise was expected to result in a total budget reduction of $36.7 million from all Regional Bureaux in 2014-2015, as outlined below:

Table 1: The budget reduction targets of the FSE exercise

Regional Bureau	Budget reduction targets		
	2014 (in $ millions)	2015 (in $ millions)	Total (in $ millions)
Regional Bureau for Africa (RBA)	8.3	7.5	15.8
Regional Bureau for Asia and the Pacific (RBAP)	3.9	3.5	7.4
Regional Bureau for Latin America and the Caribbean (RBLAC)	2.6	2.4	5.0
Regional Bureau for Arab States (RBAS)	2.4	1.9	4.3
Regional Bureau for Commonwealth of Independent States (RBEC)	2.2	2.0	4.2
Total	**19.4**	**17.3**	**36.7**

Source: Office of Financial Resources Management

The FSE exercise included:

- a review of the Country Offices' financial outlook for 2014 and 2015;
- an analysis of the required capacity;
- planning of measures to address sustainability issues and capacity gaps; and
- capturing and presenting planned changes to the respective Regional Bureaux.

The Regional Bureaux were responsible for consolidating all the Country Offices' plans as an input to the review of UNDP's overall financial outlook. The budget reductions were expected to be implemented in 2014 and 2015, alongside measures to improve the efficiency and effectiveness of Country Offices.

The 'Financial Sustainability Outlook Tool' was developed to facilitate the FSE exercise by collecting key data and to verify the outlook of the Country Offices under different scenarios. The use of the Tool was not mandatory as the FSE exercise was fully decentralized to the Regional Bureaux, and each Bureau was allowed to apply the guidance as it saw fit.
In addition to the 2013 FSE exercise, there was a proposal to repeat the FSE exercise every two years, as set out in the UNDP Resident Representative induction material issued in June 2014. However, there was no final decision taken. Therefore, the FSE exercise was considered a one-off exercise and expected to be replaced by a new change management policy.

II. Audit results

OAI made one recommendation ranked medium (important) priority.

Medium priority recommendation:

(a) Introduce a new change management policy (Recommendation 1)

The detailed assessment is presented below, per audit area:

A. Scope and governance of the FSE exercise

The 'Interim Change Management Measures' that were part of the FSE announcement in May 2013 included a provision for their replacement by a change management policy in 2014. More specifically, the document stated that "[t]he Interim Measures that enable Country Offices to make immediate progress while minimizing risks and potential liabilities, and to respond to eventual future contingencies will be replaced by a new policy on the subject in 2014."

Issue 1 Weaknesses in change management policy

Setting out clear roles and responsibilities in policy and procedure documentation is a key prerequisite in any change management process, to help ensure the effective coordination among different parties involved and the achievement of process objectives.

The 'Interim Change Management Measures' did not set out clear roles and responsibilities for key parties involved in the exercise (i.e., Bureau for Management Services, Regional Bureaux, and Country Offices). The email communication in June 2013 announcing the FSE exercise included information on roles and responsibilities; however, roles and responsibilities of the key parties involved were not clearly defined. For example, the Bureau for Management Services had a supporting role in the FSE exercise. However, its role in overall monitoring or follow-up of the FSE exercise results was not clear.

As part of the implementation of the FSE exercise, the 'Interim Change Management Measures' included the suspension of two existing policies (the 'Policy on Change Management Clearance' and the 'Policy Governing Human Resources Alignment in the Context of Change Management Measures'). This was done to offer greater flexibility to Country Offices and to help speed up the implementation of any changes.

Further, the 'Interim Change Management Measures' were not replaced by a new change management policy in 2014, as required. All 10 Country Offices surveyed as part of the audit explained that they had little policy guidance on how to implement change management when the FSE exercise was concluded.

If roles and responsibilities are not clearly defined or communicated, there is a risk that management and staff involved in the process will not be aware of what they are required to do and how to best achieve the results of the FSE exercise, leading to poor results, delays, or the failure to meet the requirements and objectives of the activity. In addition, without a complete, up-to-date change management policy, UNDP offices may lack guidance on how to complete relevant activities, fail to take appropriate HR actions as part of any change management activities, or waste time and resources when making changes to their structures.

Priority	Medium (Important)

Recommendation 1: The Bureau for Management Services should introduce, in line with the requirement of the 2013 'Interim Change Management Measures' a new change management policy, which includes definitions of roles and responsibilities of key parties involved, and clearly sets out any provisions of a temporary nature.
Management action plan: The Bureau for Management Services will incorporate the proposed elements in future change management policies. **Estimated completion date:** June 2017

B. Methodology of the FSE exercise

The FSE exercise was designed to allow each Regional Bureau a degree of autonomy in line with their diversity and distinctive challenges. Each Regional Bureau adopted its own methodology in carrying out the FSE exercise. For example, one of the Regional Bureaux calculated reduction targets for Country Offices and asked each office to determine how much of a cut it could absorb each year (2014 and 2015). Another Regional Bureau came up with a baseline staff structure for each Country Office and then asked the Country Offices to complete the office structure based on their requirements, delivery and challenges. Additionally, the Regional Bureaux adopted different approaches for reporting their FSE exercise plans to the Bureau for Management Services.

The audit did not find any reportable issues.

C. Results of the FSE exercise

Against the background of the internal core resource estimates for 2014 and 2015 (endorsed by the Executive Group during its meeting on 20 May 2013), it was agreed that a UNDP-wide reduction in the Country Offices' core budgets of 10 percent in 2014 and another 10 percent in 2015 was necessary due to the reduction in the available funding.

The FSE exercise envisaged a budget reduction of $19.4 million in 2014 and $17.3 million in 2015, or a total of $36.7 million for two years (refer to Table 1). At the end of the FSE exercise, after the review and consultation with the Office of Financial Resources Management, it was determined that all Regional Bureaux had met their reduction targets for 2014. Overall, 400 positions were affected by the FSE exercise, resulting in cost savings of $19.95 million. An analysis of the consolidated results from the Regional Bureaux showed the following reduction for 2014. Analysis for 2015 was not available at the time of the audit.

Table 2: Global reduction by posts affected in 2014

Global reduction strategy	Cost reduction (in $ millions)	Percentage (%)	No. of positions affected
Abolished posts	5.15	26	83
Temporarily frozen	1.15	6	22

Core fully shifted to extra-budgetary or development resources	6.97	35	155
Core partially shifted to extra-budgetary or development resources	3.18	16	107
New positions	-	0	0
Upward reclassifications	(0.01)	0	3
Downward reclassifications	0.50	3	21
Others	0.29	1	9
General Operating Expense	2.70	14	0
Total	**19.9**		**400**

Source: Office of Financial Resources Management

The affected staff positions (approximately 49 percent) were mainly from the Country Offices in the Africa region. Country Offices in the Asia Pacific, Arab States, Europe and the Commonwealth of Independent States, and Latin America and the Caribbean regions, reduced their general operating expenses to meet the FSE exercise target and limit the number of staff positions affected.

Table 3: Global reduction by Regional Bureau in 2014

Region	Positions affected	Cost savings (in $ millions)	Percentage reduction (%)
Africa	194	8.37	49
Asia Pacific	68	3.90	17
Arab States	42	2.49	11
Europe and the Commonwealth of Independent States	49	2.58	12
Latin America and the Caribbean	47	2.61	12
Total	**400**	**19.95**	**100**

Source: Office of Financial Resources Management

Issue 2 Management cost reduction targets not met

The Bureau for Management Services set out targets for the breakdown of the budget reductions between management expenses (80 percent of total reductions) and development effectiveness expenses (20 percent of total reductions). The Office of Financial Resources Management noted that the Regional did not achieve the cost reduction targets for management The table below shows the target and actual reductions by cost classification:

Table 4: Reduction by cost classification for 2014 and 2015

		RBA				RBAP				RBLAC				RBAS				RBEC			
		%	MGT in $millions	%	DE in $millions	%	MGT in $millions	%	DE in $millions	%	MGT in $millions	%	DE in $millions	%	MGT in $millions	%	DE in $millions	%	MGT in $millions	%	DE in $millions
2014	Target	80	6.60	20	1.70	80	3.12	20	0.78	80	2.1	20	0.5	80	1.9	20	0.5	80	1.74	20	0.46
	Actual	48	4.00	52	4.30	69	2.70	31	1.20	75	1.91	25	0.64	54	1.3	46	1.1	75	1.63	45	0.96
2015	Target	80	6.00	20	1.50	80	2.80	20	0.70	80	1.9	20	0.5	80	1.5	20	0.4	80	1.62	20	0.38
	Actual	15	1.10	85	6.40	68	2.65	22	0.85	78	1.86	20	0.48	74	1.4	26	0.5	69	1.37	11	0.23

MGT = management DE = development effectiveness

Source: Office of Financial Resources Management

With the target percentage reductions in management costs not being met, important development effectiveness funds may have to be utilized to cover funding gaps in management costs, which may reduce the overall effectiveness of UNDP's work.

OAI Comment:

Considering that the FSE exercise has already concluded, OAI is not issuing a recommendation to address the shortfall in achieving the management cost reduction targets. The issue was discussed with UNDP management for future reference.

Issue 3 Lack of focus on Country Office operational changes

The communication from the Bureau for Management Services announcing the start of the FSE exercise as well as the 'Interim Change Management Measures' guiding the exercise, set objectives related to budget reductions as well as the need for reviewing and changing the way the Country Offices operate, including the staff and organizational structure of each office, to make them more effective in their operations.

Through the analysis of the FSE exercise documentation, communications, and discussions with a sample of 10 Country Offices, it was noted that in practice, the FSE exercise results were assessed primarily in terms of budget reductions. The importance of reviewing the Country Office structure or the overall business model did not form part of the analysis that was conducted in late 2013 by the Bureau for Management Services, as its focus was on whether the budget reduction targets would be met by each Regional Bureau.

OAI Comment:

Considering that the FSE exercise has already concluded, OAI is not issuing a recommendation to address the lack of focus on Country Office operations changes. The issue was discussed with UNDP management for future reference.

Issue 4 Lack of overall assessment and follow-up of FSE exercise results

The FSE exercise included a requirement for Regional Bureaux to provide consolidated plans to the Bureau for Management Services by September 2013 to analyse the results. Additionally, an analysis of the final results,

conclusion and lessons learned from a management exercise is generally considered as a good practice that helps management take relevant and appropriate follow-up actions.

All Regional Bureaux submitted consolidated FSE exercise plans, which were reviewed by the Office of Financial Resources Management, primarily to determine whether the Regional Bureaux were able to achieve the budget reduction targets set out by the Bureau for Management Services in June 2013. The report produced by the Office of Financial Resources Management included a number of observations and next steps. These included administrative requirements, such as the Regional Bureaux providing the chart of accounts for all positions moved to 'development resources' as well as suggestions to the Regional Bureaux, such as providing more realistic revenue projections to the Bureau for Management Services or taking advantage of the Direct Project Costing mechanism.

Other than the internal analysis carried out by the Regional Bureaux, there was no further reporting, communicating, or reflecting on UNDP-wide lessons learned from the FSE exercise and ways to take the Country Offices and Regional Bureaux forward in 2014, 2015 and beyond.

OAI Comment:

Considering that the FSE exercise has already concluded, OAI is not issuing a recommendation to address the lack of an overall assessment and follow-up of the FSE exercise results. The issue was discussed with UNDP management for future reference.

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.