



AUDIT

OF

UNDP PROJECT MANAGEMENT OFFICE

IN

CYPRUS

Report No. 1879

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Report on the Audit of UNDP Project Management Office in Cyprus Executive Summary

The UNDP Office of Audit and Investigations (OAI) conducted an audit of UNDP Project Management Office in Cyprus (the Office) from 10 to 21 July 2017. 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 (leadership, corporate direction, corporate oversight and assurance, corporate external relations and partnership);
- (b) Project Management (quality assurance process, project design and implementation, knowledge management);
- (c) operations (financial resources management, ICT and general administrative management, procurement, human resources management, and staff and premises security); and

The audit covered the activities of the Project Management Office from 1 January 2016 to 31 May 2017. The Office recorded programme and management expenses of approximately \$12 million. The last audit of the Project Management Office was conducted by OAI in 2011.

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

Overall audit rating

OAI assessed the Project Management Office as **satisfactory**, which means “The assessed governance arrangements, risk management practices and controls were adequately established and functioning well. Issues identified by the audit, if any, are unlikely to affect the achievement of the objectives of the audited entity/ area”.

Key recommendations: Total = **3**, high priority = **0**

The audit did not result in any high (critical) priority recommendations. There are four medium (important) priority recommendations, which means “Action is required to ensure that UNDP is not exposed to risks. Failure to take action could result in negative consequences for UNDP.” These recommendations include actions to address: Risk management not properly documented, exit strategy and capacity building plans not established, Outstanding closure of project ‘New Nicosia Wastewater Treatment Plan’, and Commitments without available cash.

The three recommendations aim to ensure the following, (a) reliability and integrity of financial and operational information (Recommendation 3); and (e) compliance with legislative mandates, regulations and rules, policies and procedures (Recommendations 1 and 2).

Management comments and action plan

The Deputy Regional Director, Regional Bureau for Europe and the Commonwealth of Independent States accepted all of the recommendations and is in the process of implementing them. Comments and/or additional information provided have been incorporated in the report, where appropriate.

Low risk issues (not included in this report) have been discussed directly with management and actions have been initiated to address them.

A handwritten signature in blue ink is enclosed in a rectangular box. The signature is stylized and appears to read 'Helge S. Osttveiten'.

Helge S. Osttveiten
Director
Office of Audit and Investigations

I. About the Office

The Office is located in Nicosia, Cyprus (the Country). The Country is divided by a zone under the control of the United Nations Peacekeeping Force (UNFICYP), separating the Turkish Cypriot community in the north, from the Greek Cypriot community in the south. In 2001, UNDP became responsible for the implementation of the European Union funded Programme "Partnership for the Future" to continue work on the Nicosia Master Plan and support infrastructure development. In 2004, the Country became a member of the European Union (EU), with the common body of law regulating trade and movement within the EU suspended in the northern part of the island. In recent years the Office's focus was on the bi-communal projects facilitating access to wastewater services to both communities of Nicosia through the project for the New Nicosia Waste Water Treatment Plant, support to the Technical Committee on Crossings, support to the Technical Committee on Cultural Heritage for the preservation and promotion of the immovable cultural heritage of Cyprus, and providing operational support to the Committee of Missing Persons in the Country. A major share of the UNDP projects was being implemented in the northern part of the country.

At the time of the audit the Office was comprised of two staff members and nine service contract holders

II. Audit results

Satisfactory performance was noted in the following areas and sub-areas:

- (a) Operations/Financial Resources Management: The sample review of 32 vouchers totalling \$119,000 demonstrated that adequate controls were established. No reportable issues were identified.
- (b) Operations/ICT and General Administrative Management: ICT systems managed by the Office including hardware, software and system security were operating effectively. General Administrative controls were well established and functioning adequately. The management of assets and travel were in line with UNDP policies and procedures.
- (c) Operations/Human Resources Management: Adequate controls were established and the review of recruitment and separation processes did not identify any reportable issues.
- (d) Operations/Staff and Premises Security: The Office was 96 percent compliant with the requirements of the Minimum Operating Security Standards. The Country Security Plan and Security Risk Assessment were updated and endorsed. No reportable issues were identified.

OAI made four recommendations 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 recommendations, arranged according to significance:

- (a) Coordinate with the Regional Bureau to set up a comprehensive and documented risk management plan (Recommendation 1).
- (b) Ensure the budget override authorisation when needed (Recommendation 3).
- (c) Ensure the timely closure of the project by concluding Phase 1 (Recommendation 2).

The detailed assessment is presented below, per audit area:

A. Governance

1. Corporate oversight and assurance

Issue 1 Risk management processes not properly documented

Risk and uncertainty are inherent to many of UNDP's activities. According to the UNDP Enterprise Risk Management process, risks should be identified, analyzed, evaluated and reported. Also, a risk treatment (action plan) should be set up and risks should be documented in a Risk Register.

The audit noted the lack of a properly documented risk management process and action plan. The audit also identified two risks which should have been managed through the risk management process

- The Office signed construction contracts with companies who were not properly registered under the Country law. Therefore the Office did not address the risks of a claim from a controversy or dispute arising out of, or in connection with the contracts. This risk was not documented on the Risk Register and it was not managed in accordance with the UNDP Enterprise Risk Management process. The Office management indicated that the risks were discussed with the Regional Bureau and the Legal Support Office.
- The Local Project Appraisal Committee comprised only of UNDP representatives without local counterparts and other stakeholders. Although local counterparts and stakeholders were involved in the preparation of project documents prior to submission to the Committee, they did not participate in the appraisal and approval process of project documents. Furthermore, project documents were signed only by UNDP as implementing partner, with no signature from the Government or from any local coordinating organization. Stakeholders' participation in the formulation and approval of project documents promotes ownership, sustainability and commitment, without which the results are unlikely to last. The Office management explained that due to the political context it could not pursue the Government signature on the project documents.

The lack of properly documenting, analysing and managing risks, may make the Office face a higher level of risk than what would be in accordance with the Organization's risk appetite.

Priority	Medium (Important)
Recommendation 1:	
The Office should coordinate with the Regional Bureau to set up a comprehensive and documented risk management plan in accordance with the UNDP Enterprise Risk Management process, and address issues relating to the construction contracts and membership of the local appraisal committee.	
Management action plan:	
The recommendation is noted and accepted. During OAI's mission a number of the above mentioned risks had been recorded in the Integrated Work Plan. The comments made by OAI as well as other identified risks will be further considered, duly reflected and monitored through the UNDP Enterprise Risk Management process/system. Additionally, the UNDP Regional Bureau and the Office have agreed to develop a risk-log	

document to manage risks effectively and proactively in the future. A thorough review process will be conducted at least twice a year by the Bureau with inputs from the Bureau for Management Services/ Legal Support Office and the Istanbul Regional Hub Operations Team. Bearing in mind political sensitivities, the Bureau will consider options for possible engagement of counterparts into the project formulation and appraisal process and will revise its memo on the Project Appraisal Committee review process and composition; as well as set a procedure for signing of the project documents.

Estimated completion date: February 2018

B. Project Management

1. Project design and implementation

Issue 2 Outstanding project closure

The 'UNDP Programme and Operations Policies and Procedures' indicate that a project should be closed if: the end of the final annual work plan is approaching; when a project delivers its planned outputs; or if it becomes apparent that the project is no longer viable. These events cause the Project Board to recommend the closure of the the project.

The project 'New Nicosia Wastewater Treatment Plant' started in July 2009 and aimed to promote and facilitate access to wastewater services for both communities of Nicosia, as a contribution to the on-going peace and confidence building process. The contracts signed with the contractor included two phases: Phase 1, design and construction of the plant, under the scope of the project activities; and Phase 2, services on the operational management of the plant, under the administration of both communities. The construction of the plant started in March 2010 and was completed in June 2013. The plant started operations in July 2013 under the control of the communities. The handover of the works to the communities and the conclusion of the Phase 1, however, could not be finalized, due to the unmet technical conditions of the contract (low biogas production) and thus, the performance certificate for the completion of the works and their final payment could not be issued as of the date of the audit. As of the date of the audit, the project status in Atlas was 'on-going'.

The Office management, as a final settlement measure to close Phase 1, drafted an agreement between the contractor and the involved parties, including the donor, on May 2017, subject to the approval of the two communities' Boards. The audit noted that even though the UNDP Legal Support Office was engaged in previous negotiations, it was not aware of the terms and conditions of the final draft agreement. As of the date of the audit, the Boards of the two communities had not yet approved the agreement. The Office management indicated that the agreement would be implemented by September 2017.

Delays in obtaining the communities' formal approval to the agreement and in closing the project properly, may put the Office under legal and reputational risk.

Priority	Medium (Important)
Recommendation 2:	
The Office should ensure the timely closure of the project by concluding Phase 1, including seeking advice from the Legal Support Office on the agreement conditions.	
Management action plan:	
The recommendation is fully accepted. It has been a high priority for the Bureau since completion of Phase 1 in 2014. The Regional Bureau and the Legal Support Office are fully informed and involved in finding a mutually acceptable legal solution with the Cypriot partners, as well as the contractor and the donors. Following several rounds of negotiations during 2016-17, the parties have reached an agreement in principle that Phase 1 will be finalized by the end of 2017. The closure process is to proceed regardless of outstanding items concerning Phase 2, which is outside UNDP's responsibility. Cypriot partners have been notified via email of the next steps and actions that will be taken by UNDP and the Contractor/WTE during October-November 2017. The Bureau will continue to monitor and support the efforts.	
Estimated completion date: December 2017	

C. Operations

1. Procurement

Issue 3 Incomplete budget authorization practise

In accordance with the 'UNDP Internal Control Framework', offices do not have the authority to enter into commitments in the absence of available cash. The Office had established a proper budget override policy, which was approved by the Deputy Regional Director of the Regional Bureau for Europe and the Commonwealth of Independent States. The purpose of the policy was to allow the Office to proceed with initiating procurements and payments to suppliers related to the project once the donor had committed to providing funding, even though the Office did not yet have custody of the funds.

The Office signed four construction contracts amounting to approximately \$5 million, without the cash to cover for the committed amounts. However, the Office did not initiate the process of budget override authorisation according to the policy. The Office management indicated that they were making commitments only in cases where the donor agreements were in place. No payments without donor funds received were made, and these funds were usually received in several tranches.

Without properly assessing, authorizing and reconciling budget overrides, the Office may have difficulties in meeting its financial commitments.

Priority	Medium (Important)
Recommendation 3:	
The Office should ensure the budget override authorisation when needed to reflect the full amount of commitment in Atlas.	
Management action plan:	
<p>The recommendation is noted and agreed upon. To minimize risks and exposure, the Office issued/ approved purchase orders in the system for contract payments/amounts always supported by cash availability. In a few instances, the Atlas purchase orders were not for the total amount of the commitment (full amount of the contract signed) but based on cash availability and the estimated amounts to be paid to the vendors. The Office had put in place a system of outside-of-Atlas cash availability versus commitments reconciliation. The Bureau also accepts that this practice is not strictly within the policy on budget overrides and will work to find a practical solution within the applicable policy on budget override at the same time having practical arrangements in place not to disrupt Cyprus projects implementation. The Bureau and the Istanbul Regional Hub Operations Adviser will work with the Office to monitor cases which may require a budget override. This matter would be reflected as a risk and will be managed in line with the UNDP Enterprise Risk Management procedures. Furthermore, as UNDP has approved a new policy for multi-year purchase orders only a few months ago, it will also be implemented in the Country.</p>	
Estimated completion date: February 2018	

Definitions of audit terms - ratings and priorities

A. AUDIT RATINGS

- **Satisfactory** The assessed governance arrangements, risk management practices and controls were adequately established and functioning well. Issues identified by the audit, if any, are unlikely to affect the achievement of the objectives of the audited entity/area.
- **Partially Satisfactory / Some Improvement Needed** The assessed governance arrangements, risk management practices and controls were generally established and functioning, but need some improvement. Issues identified by the audit do not significantly affect the achievement of the objectives of the audited entity/area.
- **Partially Satisfactory / Major Improvement Needed** The assessed governance arrangements, risk management practices and controls were established and functioning, but need major improvement. Issues identified by the audit could significantly affect the achievement of the objectives of the audited entity/area.
- **Unsatisfactory** The assessed governance arrangements, risk management practices and controls were either not adequately established or not functioning well. Issues identified by the audit could seriously compromise the achievement of the objectives of the audited entity/area.

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. Failure to take action could result in 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.