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Items 3 and 4 of the provisional agenda

# INTERIM REPORT OF THE EXTERNAL AUDITOR, FINANCIAL PERFORMANCE REPORT AND PROGRAMME PERFORMANCE REPORT FOR THE BIENNIUM 2004-2005

## IMPLEMENTATION OF THE RECOMMENDATIONS OF THE EXTERNAL AUDITOR

Interim report of the External Auditor on the accounts of the  
United Nations Industrial Development Organization for the financial period 2004-2005

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AUDITOR-GENERAL  
P.O. Box 446 PRETORIA 0001  
REPUBLIC OF SOUTH AFRICA  
TEL (012) 426 8401  
FAX (012) 426 8257

14 March 2005

The President of the Industrial Development Board  
United Nations Industrial Development Organization  
Vienna International Centre  
P.O. Box 300  
A-1400 Vienna  
Austria

Dear Sir/Madam

#### LETTER OF TRANSMITTAL

I have the honour to present to the thirtieth session of the Industrial Development Board my interim report on the accounts of the United Nations Industrial Development Organization for the period 1 January 2004 to 31 December 2004. The financial statements, which are included in the Interim Report of the External Auditor, Financial Performance Report and Programme Performance Report for the Biennium 2004-2005, have not been audited and no audit opinion is expressed thereon.

In transmitting my report I wish to advise that, in accordance with the United Nations Industrial Development Organization's Financial Regulations, I have given the Director-General the opportunity to comment on my report. He has indicated that he has no further comments to make.

Yours sincerely

[Signed]

S. A. FAKIE  
EXTERNAL AUDITOR  
AUDITOR-GENERAL OF THE  
REPUBLIC OF SOUTH AFRICA

### I. INTRODUCTION

1. The audit of the United Nations Industrial Development Organization (UNIDO) was assigned to the Auditor-General of the Republic of South Africa for the 2004-2005 financial period by resolution GC.10/Dec.16 adopted at the tenth regular session of the General Conference. It is a great honour to submit my interim report on the salient matters arising from the external audit to the thirtieth session of the Industrial Development Board (IDB), through the twenty-first

session of the Programme and Budget Committee (PBC).

2. Since this is my second term in office, my team can apply the valuable experience gained in the audit of the previous financial period, whilst the organisation can expect to benefit from a more streamlined and effective audit. The International Congress of Supreme Audit Institutions has recognised this in its formulation of the principles for best audit arrangements for international institutions. These principles, which were adopted in October 2004, indicate that an appointment of between four and eight years would provide a reasonable balance between the additional costs of changing the external auditor and the benefits of the change.

3. The practice of reporting in the interim year was first adopted in the previous financial period. It is not intended to express an audit opinion on the financial statements for the twelve-month period ended 31 December 2004, but rather to report on the activities carried out by external audit and any recommendations resulting therefrom.

4. This report is set out in several parts, which group my comments broadly into the areas of introductory matters and progress with the audit, a financial overview, activities carried out by the Office of the Comptroller General, performance management, procurement, the use of consultants and experts, as well as the status of implementation of my previous recommendations.

### II. SCOPE

5. The audit was carried out in accordance with Article XI of the Financial Regulations of UNIDO and the additional terms of reference governing external audit contained in the Annex thereto, as well as the Common Auditing Standards of the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency and conforms to International Standards on Auditing.

6. A comprehensive audit approach, which integrates financial, compliance and value-added aspects, is being followed. This provides the opportunity for the external auditor to add value to the accountability process in order to assist the organisation in achieving its mandate in an economical, efficient and effective manner.

### III. AUDIT PLANS/PROGRESS

7. My team conducted a strategic planning visit during November 2004 aimed at developing the audit strategy for the biennium, and performed the detailed

planning in order to update their knowledge of the organisation's business and related systems.

8. With regard to the regularity audit, detailed risk assessments have been completed to ensure that in performing the financial and compliance audit work, our resources will be appropriately focused. This was accompanied by a follow-up on the implementation of external audit's recommendations. The regularity audit will be taken forward through a pre-final audit in the last quarter of 2005 and a final audit after the closure of the financial period.

9. Our value-added work, in turn, has been scheduled to take place at various stages of the audit. During our interim visit, to which this report refers, we focused on activities carried out by the Office of the Comptroller General, performance management, procurement, as well as the use of consultants and experts. We intend to take this forward during our field office visits, at which time we also plan to evaluate the programme/project management.

10. Additional value-added work will be carried out during the remainder of the financial period with a focus on, *inter alia*, the launching of the UNIDO-UNDP cooperation for establishing the new UNIDO Desks, post-crisis industrial rehabilitation and reconstruction, financial statement presentation and disclosure, as well as a risk assessment of the information and communication technology (ICT) control environment.

11. Due to the far-reaching changes the organisation is undergoing, it would be efficient in terms of audit resources and continuity to pursue a follow-up review on, *inter alia*, the UNIDO-UNDP cooperation agreement, results-based management and the impact that the new Guidelines on the Programme/Project Cycle will have on technical cooperation delivery during the 2006-2007 biennium.

#### IV. FINANCIAL OVERVIEW<sup>1</sup>

##### A. Regular budget and assessed contributions

12. An analysis of the collection of assessed contributions was performed to evaluate the level of recovery of current assessments, as well as contributions that remain outstanding from prior financial periods.

13. The Secretariat attained a collection rate of 90.5 per cent for 2004 (2002: 93.0 per cent), a slight deterioration as compared to 2002 but still above the collection rate of 2002-2003 (89.8 per cent). However,

as previously reported, the increasing level of outstanding assessed contributions from prior financial periods of €114.0 million (2002: €111.1 million) is still of concern.

14. It is noted that the Secretariat has maintained its efforts to collect outstanding assessed contributions and negotiated four new payment plans with member states during 2004. However, follow-up in respect of former member states did not yield any payments.

##### B. Spending rate

15. The amount made available for obligating was influenced by the level and timing of the payment of assessed contributions. The organisation suffered a noticeable decrease in its spending rate for 2004 (83.6 per cent) as compared to that of 2002 (88.6 per cent).

16. Management ascribed the lower spending rate to, *inter alia*, planning for increased personnel costs during 2005 on account of launching the UNIDO-UNDP cooperation and preparing for an increased staff turnover due to staff reaching retirement age or leaving the organisation in 2005. Thus, in order to ensure prudent budgetary management, an amount of €11.9 million (2002: €7.8 million) was not released for obligation.

##### C. Technical cooperation funding and delivery

17. It is encouraging to note that an increase in technical cooperation funding was achieved in 2004 (Figure 1). This was evident from the increase in voluntary contributions received from USD 102.7 million for 2003 to USD 137.4 million in 2004 (an increase of 33.7 per cent). The highest growth was in respect of the organisation's trust funds.

18. I noted an accompanying increase in technical cooperation delivery to a level of USD 98.8 million, a promising indicator for the future. We expect the Interim Management Control Framework and the proposed new Guidelines on the Programme/Project Cycle to have a positive impact thereon. It is encouraging to note that the new guidelines take into account the principles of results-based management.

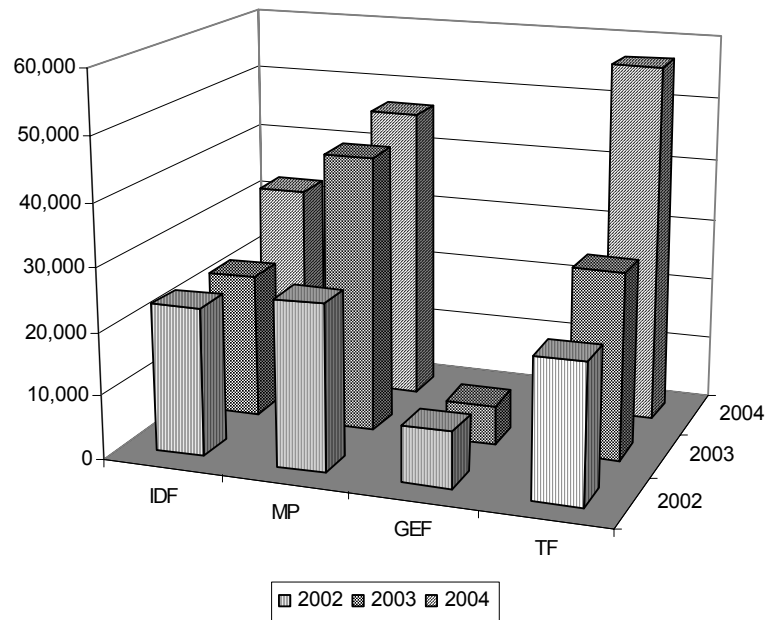
##### D. Investment balances

19. We found that cash and investment balances were well managed. Cash balances were maintained at a minimum level to provide the organisation with maximum returns on investment (Figure 2).

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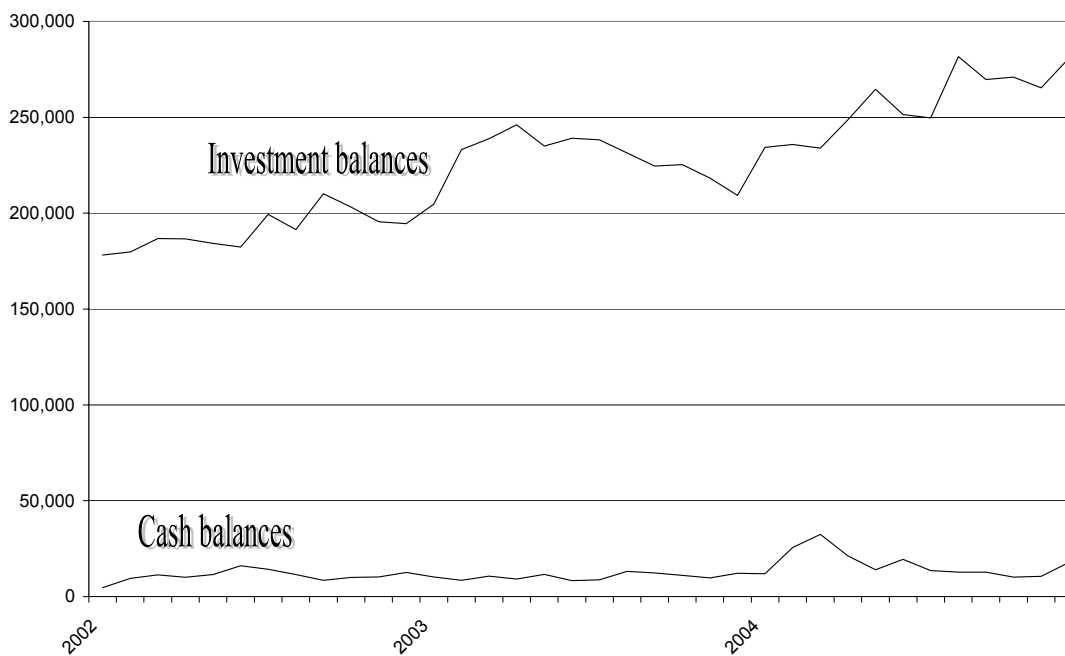
<sup>1</sup> The financial overview is based on provisional 2004 amounts obtained from ADM/FIN.

**Figure 1: Technical cooperation funding (USD'000)**



**Key: Industrial Development Fund (IDF); Montreal Protocol (MP); Global Environmental Facility (GEF); Trust Fund (TF)**

**Figure 2: Month-end cash and investment balances (USD'000)**



#### **E. Imprest accounts**

20. It was noted that, although imprest account levels had increased from USD 0.9 million (2002 year-end) to USD 1.8 million (2004 year-end), the administration of these accounts was well managed. Field offices motivated the opening of imprest accounts by achieving savings on the service charges related to payments made through UNDP.

### **V. STATUS OF IMPLEMENTATION OF RECOMMENDATIONS**

21. In the 2002-2003 financial period I issued three management letters containing a significant number of recommendations. The Secretariat provided their comments, which were verified during the interim audit. I was pleased to note that, whilst certain matters may take more than a year to address, most of the recommendations made had already been implemented. These included strengthening of the internal oversight function and the development of policies and procedures, albeit in draft format, to address aspects of fraud awareness and the general information and communication technology control environment. I have prepared as Annex A of this report a tabular inventory reflecting those key recommendations that were still at various stages of the implementation process.

22. The Office of the Comptroller General has proved to be helpful in facilitating the implementation of external audit recommendations. We have built a relationship of mutual respect and I am regularly consulted to provide comments on new and revised guidelines. We are currently considering a number of improvements for monitoring the implementation of recommendations.

### **VI. OFFICE OF THE COMPTROLLER GENERAL (OCG)**

23. Oversight entails a wide spectrum of activities including, *inter alia*, internal audit, evaluation, inspection, monitoring and performance management. In my previous report (PBC.20/3) I alluded to the establishment of the Office of the Comptroller General (OCG) as being instrumental in strengthening the internal oversight function. The OCG has since made significant progress in fostering the principles of good corporate governance, with particular emphasis on the concepts of integrity and accountability.

24. Particular note has been taken of a number of achievements by the OCG in developing policies and guidelines, performing assessments and evaluations, as well as ensuring that senior management takes prompt action in the implementation of its recommendations.

The Comptroller General is to be complimented on his achievements in managing this structure within the limited resources available. Some of the salient successes flowing from this office included the following:

#### **A. UNIDO-UNDP cooperation agreement**

25. In my previous report (PBC.20/3) I welcomed the Office of the Comptroller General's comprehensive review of the organisation's field representation. I am pleased to note that the organisation has since entered into an agreement with the UNDP in September 2004, which will promote the expansion of its field presence.

#### **B. Results-based management**

26. I had also reported previously, that the organisation had developed a results-based management system. A review conducted by the Office of the Comptroller General has contributed to the implementation of this system and to incorporating those concepts and principles in the 2006-2007 budgetary cycle, as well as the new guidelines on the programme/project cycle.

#### **C. Fraud-prevention strategy**

27. My team had identified the lack of a formal, comprehensive fraud-prevention strategy during the previous audit. I am pleased to note that the Office of the Comptroller General has drafted a policy on fraud awareness and prevention on which I have also provided my comments. The Secretariat has informed me that this document would be issued shortly.

#### **D. Information and communication technology (ICT) policies and procedures**

28. In my assessment of the ICT control environment I reported that ICT policies had not been formalised and that a disaster recovery and business continuity plan had not been developed. I have since confirmed the existence of a draft business continuity and disaster recovery plan. My team has also provided the OCG with comments on a draft ICT policy document.

#### **E. Evaluation activities**

29. During my review, I noted that effective and efficient mechanisms were in place to follow up on the implementation of recommendations made by the Evaluation Group. Note was also taken of document IDB.29/14, which provided a report on the activities of the Evaluation Group, including chapters on various aspects of the group's activities, lessons learned and action taken by the Secretariat on recommendations made. It was also noted with satisfaction the emphasis placed by senior management on the timely

implementation of such recommendations by programme/project managers.

30. The Office of the Comptroller General is now firmly established in accordance with the OCG Charter which was issued during September 2004 as called for by the tenth General Conference in GC.10/Res.10. I believe that, while maintaining and further refining the control environment that has been developed, OCG could now focus more on issues, such as taking forward measures to institutionalise results-based management, review of programme/project implementation, decentralisation/field representation, staff development and performance management, within the budgetary resources available.

## VII. INTERNAL OVERSIGHT GROUP (IOG)

31. The work of the Internal Oversight Group is focused on the activities normally associated with internal auditing. The use of the name internal oversight is therefore something of a misnomer and could perhaps be reconsidered. In my previous report (PBC.20/3) I raised various matters regarding the capacity and methodology of the group. Considerable progress has since been made with, *inter alia*, the application of the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors (IIA), improving audit plans and working papers, quality assurance, as well as with the acquisition of additional skills and resources. During the course of carrying out this follow-up audit work, several other aspects arose and I would like to make mention of a few further improvements that may be useful:

### A. Deployment of resources

32. The business dynamics which necessitate urgent assignments being afforded priority, coupled with aspects such as the organisation's zero-tolerance towards fraud, necessitated that the IOG be available for ad hoc investigations. This resulted in resources that had been allocated according to the approved work plan being re-deployed. Although the scheduled reviews of the financial, managerial and operating information of the organisation, as well as the underlying internal control processes, were carried out, several other important tasks could not be attended to. These included the audits of building management services, procurement and the use of consultants.

33. It is submitted that an estimate could be made of resources that are likely to be needed for these high-priority *ad hoc* engagements. This would then make the level of resources that can be planned for regular engagements in the work plan more realistic. The Secretariat has advised that audits not conducted in

2004 and considered high risk, would be considered for rollover into the 2005 work plan.

### B. Technology-based audit techniques

34. Our review of IOG working papers and enquiries from staff revealed that the use of computer assisted audit techniques (CAATS) was limited and that CAATS software was not used in the execution of engagements. IIA standards require that internal auditors should make adequate use of technology-based audit techniques to enable them, *inter alia*, to perform manually-intensive tasks more economically and efficiently. This could initiate savings and provide a measure of relief for the already stretched resources. The IOG has indicated that the use of CAATS would be considered within the limits of its resources.

### C. Risk management strategy

35. I had previously reported that the risk assessment processes followed by IOG warranted improvement. However, in my review of the 2004 work plan, it was noted that a formal risk management strategy to identify and prioritise risk indicators had not yet been implemented. The Office of the Comptroller General explained that considerable progress has been made and that an audit risk assessment policy had been developed to assist in the compilation of the 2005 IOG work plan. I have recently provided comments on a draft policy, which has been compiled by the Secretariat.

### D. OCG/IOG hotline

36. A hotline was introduced during 1999 as a means for staff to communicate complaints or information concerning the possible existence of fraudulent activity, waste, abuse or other irregularities. However, no activity has been recorded for some time, which could perhaps be ascribed to a problematical link to the website, perceived anonymity, the promotion of the facility itself, or simply to an absence of matters to report. This instrument could serve a useful purpose and its use could be facilitated more actively. The Secretariat has explained that the upcoming issue of the fraud awareness policy could be seen as a first step in stimulating visibility and that direct links to the hotline from the organisation's website and Intranet could be considered.

### E. Implementation of OCG/IOG recommendations

37. In terms of its charter, IOG should follow up on the implementation of its recommendations resulting from audits/reviews and determine whether effective action had been taken within the stipulated time frames. The IOG has been attending to this on an informal basis,

but subscribes to the benefits which can be derived from introducing a formal tracking mechanism to monitor the complete and timely implementation of its recommendations.

#### **F. Quality assurance**

38. The IIA standards require a quality assurance and improvement programme to be developed and maintained, to cover all aspects of the internal audit activity and to continuously monitor its effectiveness. This could take place through various mechanisms. Whilst we were satisfied with the current level of review, it would also be useful to introduce the use of a quality control checklist as an integral part of the standard working papers on each engagement. The Secretariat has undertaken to introduce a single tracer document that would identify key steps in a given engagement and will consider integrating quality assurance elements therein.

### **VIII. PERFORMANCE MANAGEMENT**

39. As part of the second phase of the human resource management framework, the Director-General, through Administrative Instruction No. 15 dated 26 July 2002, introduced a new and simplified performance appraisal system. The new system has proven to be a significant improvement on the previous system that was found to be complex, discouraged dialogue and could not be used effectively as a management tool. Our review of this system was conducted on a test basis and I would like to make mention of a few further improvements which may be useful:

(a) New goals to be achieved and main assignments to be carried out by staff were not always clearly identified and negotiated at the beginning of the reporting period. Identifying and negotiating goals at the beginning of a reporting period allows managers to measure performance against predetermined goals/assignments at the end of a reporting period. The Secretariat ascribed the phenomena highlighted by my team to the number of organisational restructurings that had taken place since the introduction of the performance appraisal system, but noted that a performance appraisal campaign will be adopted in May 2005, and yearly thereafter, to address the problem.

(b) The goals and/or main assignments that were assessed were largely taken from job descriptions and therefore not necessarily aligned to the respective annual work plans. The Secretariat noted that, with the recent introduction of results-based management, divisions would have objectives/work plans that could be cascaded down to staff members as individual objectives. We also noted that the reporting cycle for performance appraisals (July to June) was not aligned

with the annual work plans (January to December). The Secretariat has undertaken to review the merits and demerits of the present cycle and take a decision before the end of 2005.

(c) The Director-General's Administrative Instruction indicates that the appraisal process should preferably be concluded within the last month of the reporting period. However, the appraisals were not always concluded in good time. The Secretariat commented that it had a number of mechanisms for ensuring that supervisors complete performance appraisals on time, which was linked to the extension of contracts, promotions, merit increments and separations. The Secretariat added that it has gradually succeeded in changing the culture of non-compliance, that there has been a progressive increase in the rate of return and that it aims at fostering a culture of continuous dialogue.

40. We noted that the organisation was duly circumspect in the use and allocation of resources, bearing in mind budgetary constraints. This factor should be carefully considered when preparing work plans to prevent staff from having to perform at levels that cannot be sustained.

### **IX. PROCUREMENT**

#### **A. Scope of the review of procurement management**

41. I performed a limited review of procurement, which indicated that there is generally a satisfactory level of compliance with the procurement rules, procedures and administrative instructions. While this is recognised, there are areas for further improvement, as discussed below. A number of high-level recommendations have been made, which if properly implemented, could further strengthen the procurement process.

#### **B. Overview of procurement**

42. Procurement is arguably one of the organisation's critical activities. The unique nature of its activities calls for a special working relationship between Procurement Services and the substantive branches of the Programme Development and Technical Cooperation Division in view of the technical, complex and project-specific nature of the requirements for goods and services.

43. The budget for the administration of the Procurement Services/General Services, after recosting, amounted to €7.9 million for the 2004-2005 biennium, which represents an increase of 3 per cent compared to the budget of €7.6 million for the previous biennium. The service carries a staff complement of fourteen, which has remained relatively static for the last four years. The procurement of goods and services, which



forms part of the technical cooperation programmes, was budgeted at a level of €189.8 million for the 2004-2005 biennium, a decrease of 2 per cent from the 2002-2003 biennium budget of €193.6 million. Overall, these figures are aligned with the organisation's expectation that its level of technical co-operation delivery will remain largely unchanged.

44. There has been an increase of 14.2 per cent in the total procurement of goods and services for the delivery of technical cooperation activities, including the UNIDO headquarters requirements from USD 61.1 million in 2003 to USD 69.8 million in 2004. More specifically, in 2004 technical cooperation procurement amounted to USD 49.9 million (2003: USD 50.2 million) and headquarters procurement amounted to USD 19.9 million (2003: USD 10.9 million).

45. Economical, efficient and effective procurement is instrumental in the achievement of the organisation's key goals and objectives. Bearing in mind its complex nature and integration into the service delivery as a whole, it needs to be strategically aligned to the business as a whole. The Procurement Services has identified a number of key aspects that will assist in further strengthening the process, notably:

(a) adopting a strategic approach to procurement;

(b) improving procurement and contract strategies; and

(c) improving the systems to ensure the availability of detailed management information on procurement activities.

#### **C. Procurement workshops**

46. A number of procurement workshops were held in 2002 and 2003, which focused on active and dynamic procurement. While many of the findings were translated into positive action, there did not appear to be a structured manner in which those workshop findings are taken forward. It should be confirmed that all the relevant findings have been coupled with appropriate action plans to ensure that all the aspects identified have been properly addressed.

#### **D. Computerisation of the procurement system**

47. The shortcomings of the existing procurement computer systems were analysed to identify opportunities for improvement. Terms of reference were compiled during December 2004 for the in-house development of a computerised procurement system, which were under review by the Information and Communication Management Service. External audit welcomes this initiative to modernise the procurement

system, which should carry significant benefits. To take full advantage of this initiative, it is suggested that the following matters be addressed:

(a) Ensure that the terms of reference also address, *inter alia*, matters relating to security, electronic approvals, proper segregation of responsibilities, and backup arrangements. During this process the continued adequacy of controls should be carefully considered.

(b) Review existing policies, procedures and guidelines to determine whether they are sufficiently flexible to cater for the requirements of a computerised procurement process.

(c) Set specific target dates for the planned development of the computerised system to ensure that it is implemented within a reasonable time frame, bearing in mind the overall availability of resources.

(d) Take steps to ensure that all staff members involved in the procurement process are fully conversant with the application of the proposed procurement system.

#### **E. Procurement guidelines**

48. The Secretariat introduced guidelines during November 2004 to further assist the substantive branches with the preparation of the terms of reference and technical specifications for the procurement of goods and services under the technical co-operation programmes. Supplementing these guidelines, the Secretariat issued additional draft guidelines on procurement, which were prepared, *inter alia*, in response to the findings of 2003 procurement workshops. I welcome these initiatives and would urge their early finalisation and approval.

#### **F. Performance measurement of the procurement function**

49. The existing procurement systems did not provide the underlying systems needed to effectively monitor performance against the activities and outputs set by the unit. Performance indicators were generic in nature and, therefore, did not lend themselves to proper measurement.

50. The performance indicator on the average length of the procurement cycle is not clearly linked to the stipulated procurement lead times. It could not be established at the time of the review whether UNIDO actively monitored and reported on the length of time to complete a procurement cycle.

51. A high-level review of five contracts indicated that there had been several delays, in some cases for

months, particularly in the areas of technical and financial evaluations of bids received. While it is recognised that technical co-operation procurement and contracts are often of a complex and specialised nature, the organisation should implement measures to track the progress of procurement activities against established lead times. UNIDO should also investigate the underlying reasons for any delays and take remedial action, where necessary.

#### **G. Procurement planning**

52. The substantive branches of the Programme Development and Technical Co-operation Division prepared individual procurement plans, based on guidelines that had been issued by the Secretariat. The high rate of response from the substantive branches in completing their procurement plans is commendable.

53. A review of individual procurement plans indicated that while some were completed to a large degree, others provided insufficient information. The following areas may be considered to enhance the use of the procurement plan as a management and monitoring tool:

(a) Potential suppliers should already be indicated.

(b) The plan should indicate the method of procurement, in line with the Procurement Manual and existing guidelines.

(c) In addition to the estimated date of raising requisitions, consideration may be given to include the estimated time for delivery.

(d) Potential requests for waiver should be indicated, together with a motivation.

54. It was not clear at the time of the review whether the procurement plan was used in the management, control and review of the procurement of goods and services, as intended. The Procurement Services should investigate ways in which the procurement plan can be enhanced as a tool in the management of the entire procurement process.

#### **H. Procurement staff training**

55. Procurement staff members generally have several years experience with a relatively high level of proficiency in the management of the day-to-day procurement activities. Although procurement training needs were identified and communicated to HRM, it appears as if this identification process was not done in a structured manner.

56. Procurement Services should identify priorities for the guidance and training of its staff members in a structured manner, for example, based on the outcomes of their performance evaluations, and with reference to the organisation's procurement requirements and the Service's performance.

#### **I. Declaration of independence**

57. All employees of UNIDO and its management are required to subscribe to the Standards of Conduct for the International Civil Service. These standards state, *inter alia*, that "international civil servants may be required to disclose certain personal assets if this is necessary to enable their organisations to make sure that there is no conflict. They should voluntarily disclose in advance possible conflict of interest that arise in the course of carrying out their duties". This is required specifically in the area of procurement.

58. It is recognised that the organisation has well-developed policies, rules and regulations to ensure that adequate controls are in place to manage procurement activities effectively and efficiently. Equally, dealings with staff members revealed that there is a culture of integrity and ethics. However, as a good practice, consideration could also be given to requiring of staff members and others involved in the procurement process, a periodic declaration of potential conflicts of interest that may arise in the course of carrying out their duties. The Secretariat indicated that this matter would be raised for further consideration at the planned workshop later in 2005.

#### **X. USE OF CONSULTANTS AND EXPERTS**

59. We reviewed the use of consultants and experts on the Global Environmental Facility (GEF) and Montreal Protocol (MP) funded projects. Our initial review at headquarters covered 2004 and focused mainly on the areas of recruitment and contract management. The intention is to extend our audit work in this regard to field offices later this year, with particular emphasis on the use of national experts.

##### **A. Pre-recruitment - consultants roster**

60. Project managers are required to identify suitable candidates for assignments by using the consultants roster as the primary source. Potential candidates who are not included in the roster have to be submitted for inclusion before they can be considered for short-listing. As an additional control measure, the human resources management ensures that candidates are placed on the roster before project managers can engage in pre-recruitment action. However, our review of the

consultants roster and recruitment documentation revealed instances where international consultants were recruited without being placed on the roster. An updated consultants roster not only provides project managers with information on suitable candidates for assignments, but also facilitates compliance with the framework, and ensures accurate quarterly reporting to senior management.

61. The Secretariat explained that it experienced problems with linking the mainframe roster system with Financial Performance Control System (FPCS) applications and that the customary clearing-up and updating exercise could not be completed due to staffing problems. However, the Secretariat expected the exercise to be completed by the end of March 2005.

#### **B. Contractual terms**

62. Consultants and experts should not be permitted to commence their duties prior to signing their contracts with the organisation. However, frequent instances were found where the contrary was permitted, which entails serious risks for the organisation, including legal and financial liability. Consideration could be given to preparing contracts well in advance for timely signature, taking disciplinary action against project managers who allow this practice to take place, as well as re-evaluating the effectiveness of processes decentralised to the field.

#### **C. Evaluation**

63. Project managers are first required to complete the evaluation of a consultant's performance, before releasing final payment on completion of the assignment. This includes an assessment of the work *vis-à-vis* the job description or terms of reference and other contractual terms. A few instances were identified where project managers did not comment on the results that had been achieved in relation to those planned or expected, thus creating uncertainty as to whether they had effected final payment only where services were satisfactorily rendered. The Secretariat undertook to introduce closer monitoring action.

#### **D. Reporting**

64. Although analytical reports on various aspects of the use of external expertise should be prepared on a quarterly basis for distribution to the Director-General, Managing Directors and the Comptroller General, I noted that the most recent reports had been prepared bi-annually only. The Secretariat explained that, based on past experience, bi-annual reporting was found to be more meaningful to the organisation than quarterly reporting and that the instructions would be re-issued to allow for this change.

### **XI. CONCLUSION**

65. At the time of my appointment as external auditor to the organisation, my predecessor in his final report to the PBC (PBC.18/3) complimented the organisation on regaining the confidence of the international community. To date, I have witnessed the organisation advance through a period of revitalisation and it is with great interest that I will follow and assess the implementation of the above-mentioned developments and many more to come.

66. In my view the organisation is well run, a view that is endorsed by a number of independent reviews and accolades on the progress made by the organisation. Accordingly, I wish to record my appreciation for the co-operation and assistance extended by the Director-General and the staff of the organisation during my audit.

[signed]

**SA Fakie**

External Auditor

Auditor-General of the Republic of South Africa

Pretoria, South Africa

14 March 2005

ANNEX A

Follow-up of the recommendations made in prior external audit reports

Below is a tabular inventory reflecting key recommendations from my report on the accounts of the organisation for the 2002-2003 financial period. These recommendations are at various stages of implementation. The recommendations that are not listed here were addressed to my satisfaction.

Recommendation	PBC.20/3	Secretariat's comments	Auditor's comments
<b>Internal oversight function:</b>			
The OCG/IOG had not subscribed to the Standards for the Professional Practice of Internal Auditors.	Par. 17(a)	The IIA standards were formally adopted by the OCG/IOG when its charter was issued in October 2003. The applicable IIA standards have largely been implemented.	The external auditor will keep it under review.
The skills and resources available within the OCG/IOG function required critical analysis.	Par. 17(b)	OCG/IOG skills and resources have received attention. The group is being further strengthened by provision of additional professional posts despite the budgetary constraints faced by the organisation.	The external auditor will keep it under review.
<b>Fraud-prevention strategy and contingency policy:</b> UNIDO did not have a formal, comprehensive fraud-prevention strategy and a contingency policy had not been developed and implemented.	Par. 21	A comprehensive policy on fraud awareness and prevention has been drafted by OCG, which takes into account the best practices from within and outside the UN system. The external auditor, <i>inter alia</i> , provided comments on this draft policy. This policy is now being finalised and is expected to be issued soon.	
<b>Environmental policy and management strategy:</b> UNIDO had not developed and implemented a formal environmental policy and management strategy.	Par. 22	A UN system-wide policy does not exist. Furthermore, it is unclear what such a policy should contain. OCG has been proactive in researching this area and collecting information from within and outside the UN system. OCG has also approached the external auditor for some guidance on the way forward.	The OCG, in consultation with the external auditor and other interested parties, will develop a policy document.
<b>End-of-service and after-service health insurance liabilities:</b> No budgetary provision has been made to cover the estimated costs of contingent liabilities for end-of-service payments to staff. Similarly, liabilities in respect of after-service health insurance have not been fully funded.	Par. 40 and 41	In view of the fact that considerable resources will be required to finance these liabilities, a UN system-wide solution is being sought. The United Nations is the lead agency on this subject. On 1 December 2004 the UN invited organisations to participate in a common actuarial study, using the UN's actuary, to value the contingent liability. The principal deliverable will be the calculation of the present value of future ASHI benefits and related accrued liabilities, taking into account the updated demographics, the experience of the current population, the retiree contributions and the actuarial assumptions. The numbers would provide the starting point for the funding strategy. UNIDO has agreed to participate in the common actuarial study. Member states will be kept informed of developments in this regard. In the meantime, the notes to the financial statements for 2004 will contain the updated figure for the contingent liability on account of ASHI based on an actuarial study carried out separately by UNIDO some years ago.	The external auditor will keep it under review.

Recommendation	PBC.20/3	Secretariat's comments	Auditor's comments
<p><b>Human resources management - recruitment and selection processes:</b> Recruitment and selection processes were largely manual and labour intensive.</p>	Par. 50	<p>Instead of attempting to develop an isolated solution for UNIDO, the OCG/ICM has looked into what is available within the UN system to determine whether such a system could be adapted to UNIDO's requirements. Such an approach is not only more cost-effective but also less risky, and also promotes partnership within the system. The Secretariat has, therefore, decided to adopt the United Nations' IMIS system for its payroll and HRM requirements. The implementation of this has been provisionally scheduled to start as from June 2005.</p>	The external auditor will keep it under review.
<p><b>General Information and communication technology (ICT) control environment</b></p>			
<p>ICT policies and procedures had not been formalised and approved. A business continuity and disaster recovery plan had not been developed, implemented and regularly tested.</p>	<b>Par. 57</b>	<p>A comprehensive ICT policy has been drafted by OCG/ICM. The external auditor, <i>inter alia</i>, provided comments on this draft policy. This policy is now being finalised and is expected to be issued shortly. A business continuity and disaster recovery plan was drafted and provided to the external auditor in November 2004.</p>	
<p>The database backup and file backup procedures that had been developed needed to be formally documented and approved.</p>	Par. 58	<p><b>The database backup and file backup procedures have been documented and are expected to be implemented shortly.</b></p>	The external auditor will keep it under review.
<p>Activity logs and access violation logs were not printed and reviewed regularly by management and an audit trail of the pursuant actions had not been maintained.</p>	<b>Par. 59</b>	<p>Some monitoring actions were taken to address these recommendations. Full implementation of these recommendations is impacted by human resource constraints; however, due attention is being paid wherever possible.</p>	The external auditor will keep it under review.
<p><b>Project documentation:</b> The filing arrangements related to project documentation had been loosely structured.</p>	<b>Par. 70</b>	<p>The procurement of an Electronic Document Management System has been completed and is currently being customised and configured for UNIDO's specific requirements.</p>	The external auditor will keep it under review.