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**Interim report of the External Auditor, including the implementation of the recommendations of the External Auditor for the biennium 2004-2005; financial performance report and programme performance report for the biennium 2006-2007**

## Programme and Budget Committee

### Twenty-third session

Vienna, 2-4 May 2007

Item 3 of the provisional agenda

**Interim report of the External Auditor, including the implementation of the recommendations of the External Auditor for the biennium 2004-2005; financial performance report and programme performance report for the biennium 2006-2007**

## Interim report of the External Auditor

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16 March 2007

The President of the Industrial Development Board  
United Nations Industrial Development Organization  
Vienna International Centre  
P.O. Box 300  
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Dear Sir/Madam

INTERIM REPORT OF THE EXTERNAL AUDITOR ON THE ACCOUNTS OF  
THE UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION  
FOR THE PERIOD 1 JANUARY TO 31 DECEMBER 2006

I have the honour to present to the thirty-third session of the Industrial Development Board, through the twenty-third session of the Programme and Budget Committee, my interim report on the accounts of the United Nations Industrial Development Organization for the period 1 January to 31 December 2006. The financial statements for the 12-month period of the biennium 2006-2007 ended 31 December 2006 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.

Yours sincerely

*[Signature]*

**Terence Nombembe**  
**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 2006-2007 financial period by resolution GC.11/Dec.16 adopted at the eleventh 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 thirty-third session of the Industrial Development Board (IDB), through the twenty-third session of the Programme and Budget Committee.
2. The practice of reporting in the interim year was first adopted in the 2002-2003 financial period. The intention is not to express an audit opinion on the financial statements for the 12-month period ended 31 December 2006, but rather to report on the activities carried out by the external auditor and any recommendations resulting from such activities.
3. 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, the status of implementation of my previous recommendations, governance matters and results-based management (RBM).

## **II. Scope**

4. 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.
5. A comprehensive audit approach, which integrates financial, compliance and value-added aspects, is being followed. This offers the external auditor an opportunity 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**

6. My team conducted a strategic planning visit during September 2006 aimed at developing the audit strategy for the biennium and, more recently, performed the detailed planning in order to update their knowledge of the organisation's business and related systems.
7. 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 course of 2007 and a final audit after the closure of the financial period in 2008.

8. 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 reviewed the progress made with the implementation of RBM. We intend to take this focus forward during our field office, pre-final and final audit visits, at which time we also plan to evaluate the impact of RBM on programme and project management.

#### **IV. Status of implementation of recommendations**

9. In the 2004-2005 financial period, I issued four management letters containing a significant number of recommendations. The Secretariat provided their comments, which were verified during this 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 the strengthening of the internal oversight function, improvements in the area of performance management, reconciliations of non-expendable property at headquarters and field offices, as well as improvements in the procurement function and the general information and communication technology control environment. I have prepared as annex A to this report, a tabular inventory reflecting those key recommendations that were still in various stages of implementation.

#### **V. Results-based management**

##### **A. Introduction**

10. I have reviewed the status of implementation of results-based management (RBM) at UNIDO at headquarters and its field offices since I reported on it for the first time in my interim report on the 2002-2003 biennium (IDB.27/6-PBC19/6). This review was conducted against the backdrop of UNIDO's project proposal for the further implementation of RBM and included a review of relevant documents and interviews with relevant officers. This project aimed to achieve improved programming and budgeting, performance monitoring and evaluation, and successful implementation of the medium-term programme framework.

11. First introduced in 2003 and 2004, RBM has been gradually implemented by UNIDO as a management tool in all its activities, *inter alia*, to become more results-orientated and to improve its reporting on performance results. In this regard, the Director-General has continued to spearhead reform measures at UNIDO by confirming on many occasions the organisation's commitment to implementing RBM. The paragraphs below summarise, in some detail, the findings and make some recommendations for consideration in the ongoing implementation of the RBM methodology.

##### **B. Institutionalisation of RBM**

12. A review of official documentation indicated that UNIDO had established a sound basis for the implementation of RBM. Various guidelines were issued to promote a common approach and understanding of the concepts and principles of RBM within the organisation. Important milestones have already been achieved in

the ongoing implementation of RBM<sup>1</sup> as a management tool for improving the organisation's performance. However, a coherent policy framework that governs the institutionalisation of RBM as a holistic management strategy still has to be developed. Such a policy could serve, *inter alia*, as a basis for the development of a time-bound comprehensive strategy for implementing RBM. It was pleasing to note that UNIDO has already recognised the need for such a coherent policy framework. Preliminary consideration of this matter has already taken place and UNIDO was of the opinion that the formulation of such a policy might require significant resources and needed to be harmonised with RBM principles in the United Nations (UN) system as a whole.

13. The introduction and further implementation of RBM within the organisation took place mainly with funding from DFID and with some limited resources from UNIDO. In order to sustain the application of RBM, including staff training, as well as the development of monitoring, evaluation and reporting systems, UNIDO emphasised the point that an investment from its regular budgetary resources would be required. In this regard, the organisation has already progressed far with the recruitment of a P-3 level officer who would spend about 50 per cent of his/her time on RBM-related activities and the other half on evaluation. While I am aware that significant additional resources may be required for the sustainable implementation of RBM, its successful implementation could result in efficiency savings, which, in turn, could be applied to further finance RBM activities.

14. Experience of RBM implementation at other UN organisations has shown that its integration into the activities of their organisations was a significant challenge, particularly in areas such as ensuring a common understanding of RBM concepts and principles among all staff members, change management issues and capacity building. UNIDO is no exception in this regard. Among other things, the organisation recognised that the successful introduction of RBM depended on a firm commitment by senior management. To ensure a coordinated implementation of RBM, the Bureau for Organizational Strategy and Learning (OSL), supported by a RBM steering committee and various focal points, assumed responsibility for overseeing this process.

15. As mentioned elsewhere, it is important to ensure that all staff members have a consistent understanding of RBM and its impact on their work. During my interaction with various focal points, it was interesting to note that there were some differences in their understanding of RBM concepts and principles. Appropriate, timely and cost-effective training therefore becomes a key element to ensure the successful implementation of RBM. UNIDO realises the importance thereof and is conducting ongoing training for the RBM focal points and various staff members in the organisation, especially those involved in technical cooperation programmes and finance. Recognising the need for wider training and capacity building, UNIDO was developing a comprehensive training plan targeted at various groups of staff members, including directors, senior managers, project officers, RBM focal points, relevant general service staff and field personnel. I recommended that UNIDO

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<sup>1</sup> Project Proposal for the Further Implementation of Results-based Management in UNIDO presented to the Department for International Development (DFID) of the United Kingdom on 24 May 2006 and approved on 26 September 2006 for the release of some US\$200 000.

should expedite the development of its training plan, which was one of the key deliverables of the senior RBM consultant recruited under the DFID-funded project.

16. Many organisations that have implemented RBM as a management tool agree that there should be a time-bound strategy for implementing RBM. This is also supported by a wide body of literature on the subject. UNIDO has recognised this, but indicated that it was not possible to assign precise time frames to the achievement of the five main outcomes listed in the logical framework because of the impact of various external factors. Instead, it has attached some time frames to the outputs associated with the individual outcomes. The inclusion of time frames is a critical component to ensure that the organisation will accomplish its stated objectives derived from UNIDO's priorities. It is also important to ensure that the time frames are systematically linked to the work plans at all levels, since the outcomes achieved by the various units influenced the outcomes achieved at the organisational level.

### **C. Programme planning, budgeting, monitoring and evaluation**

17. Learning and accountability are primary aims of results-based management. In order to achieve these aims, relevant information has to be gathered, analysed and reported at an appropriate time related to the planning and programming cycle.<sup>2</sup> Furthermore, it is important to clearly define the objectives, performance indicators and the resources required to achieve those objectives. Underlying the determination of performance indicators is the establishment of baselines and targets against which to measure performance. This forms the basis for the effective monitoring and evaluation of, as well as reporting on, the achievement of objectives.

18. UNIDO has made some progress in defining clear objectives and performance indicators, but I noted that these require further refining. For example, the performance indicators were not always specific, measurable, attainable, relevant and time bound (SMART). Linked to this, the outcomes and outputs also require some refinement. This could be ascribed to the steep learning curve with the implementation of RBM and the fact that UNIDO was still in the process of establishing and reformulating baselines and targets to facilitate more effective monitoring and reporting.

19. With the inception of the RBM-based Programme and Budgets for 2006-2007, UNIDO has given consideration to the need for developing an appropriate reporting mechanism. Following its own evaluation of reports assessing the extent to which the intended outcomes and outputs for each programme and programme component have been achieved, UNIDO concluded that gaps and discrepancies still remain in the form and content of the reports. Furthermore, UNIDO established that only 10 per cent of the programme components appeared to have a monitoring system in place. My own review confirmed this conclusion, which found that the response rate to prepare performance reports was also low at 37 per cent (19 out of 52 programme components).

20. Concerted attempts to further refine the definition of the outcomes, outputs and performance indicators with the help of its focal points were ongoing. The

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<sup>2</sup> Joint Inspection Unit report, JIU/REP/2005/6.

organisation has also taken steps to improve the implementation of reporting requirements. UNIDO was planning to use the lessons learned in the formulation of the Programme and Budgets for 2006-2007 for the compilation of the Programme and Budgets for 2008-2009.

21. RBM needs to be supported by an appropriate management information system that links the budget to the expected outcomes and tracks performance. I found that the reports submitted on the Programme and Budgets for 2006-2007 were not supported by such information or portfolios of evidence (PoE). UNIDO fully understands the need for appropriate PoE, but noted that the establishment of such a system providing a comprehensive audit trail at all levels and for all activities within UNIDO would be very resource intensive and its implementation might be constrained in the short term due to a lack of resources.

#### **D. RBM at field offices**

22. As mentioned elsewhere, it is vital that staff members at all levels in the organisation are conversant with the concepts and principles of RBM. This management tool covers both headquarters and the UNIDO field offices. UNIDO has introduced results-based work plans for field offices for 2007 with the aim of improving effectiveness and accountability of programme development and management, as well as the achievement of results. To increase staff's awareness of RBM, UNIDO prepared comprehensive guidelines on RBM principles and their expected application in the preparation of the field work plans.

23. It was reported that nine field offices had already submitted work plans by the cut-off date of 31 January 2007. Feedback from some field offices indicated the need for increased training in RBM. UNIDO has already taken steps to provide for the systematic training of field staff with the inclusion of an RBM module in the induction training of those who will be deployed to the field. The possibility of a pilot RBM training course for UNIDO representatives and heads of UNIDO operations in the West Africa region was being considered with a view to expanding training to other geographical regions, if successful. I recommend that UNIDO take steps to ensure, through ongoing training initiatives, that a coherent approach is followed in the implementation of RBM at field office level.

#### **E. Sustainable implementation of RBM**

24. My review indicates, on the one hand, that while still a work-in-progress, RBM at UNIDO appears well entrenched and incorporates many good practices, and on the other hand, that there is room for improvement. I urge UNIDO to build further on the lessons learned from its own experience and that of other UN organisations to sustain the implementation of RBM in all its activities through continuing and focused training, the enhancement of a results-based culture and improved monitoring, evaluation and reporting mechanisms.



## VI. Governance matters

### A. Office of Internal Oversight Services (IOS)

25. During my planning visit, I reviewed the audit risk assessment prepared by the Office of Internal Oversight Services (IOS), which included headquarters, field offices, Industrial Technology and Promotion Offices (ITPO) and projects. IOS prepared this assessment in line with its audit risk assessment methodology, which complies with the Institute of Internal Auditors (IIA) standards. I also reviewed the IOS work plan for 2006-2007, which takes account of the outcome of the audit risk assessment referred to above within the constraints of the allotted budgetary resources of the unit. In addition, I had discussions with IOS to ensure the coordination of our oversight activities to strengthen the organisation's internal control framework, avoid any duplication of efforts and to address the audit risks, as a combined effort. In recent times there have been some developments, as detailed in the paragraphs below, which may need consideration as to their potential impact on the internal control framework of UNIDO.

26. The UNIDO audit universe can be defined at a high level as the operational activities of the headquarters, including field offices, UNIDO Desks and the ITPOs. The organisation has increased its field representation significantly, which, expressed in number of locations, totals more than 70, excluding National Cleaner Production Centres and subcontracting and partnership exchanges.<sup>3</sup> OIS should consider the impact of this increase on its work and its preparedness to cover the expanding audit universe and the associated risks to determine the nature and extent of assurances that it may need to provide, bearing in mind the allocated resources at its disposal.

27. Organisations in the UN system are recipients of voluntary contributions from a variety of donors. Some donors have increasingly attached conditions to these funds, which they provide to organisations by requiring assurance arrangements over and above those provided by the existing oversight functions, such as internal and external audit. UNIDO endorses the single audit principle and abides by its financial regulations and rules, which provide that the organisation's operations are, exclusively, subject to internal and external auditing procedures. As such, these additional assurances are provided by the organisation's internal and external audit.

28. During my interim visit, I reviewed the activities of the IOS for 2006. My review included a comparison between the actual activities and those planned as per the IOS work plan, an analysis of the nature of its activities, as well as the unit's time attendance records. My review revealed that the unit largely succeeded in executing its work plan, with the exception of the planned review of the procurement services unit, which was in the initial stages of planning, the IOS external quality assessment that was required in terms of the IIA standards, as well as the formal tracking of the implementation of IOS recommendations. Some carry-over also occurred on investigative and fact-finding matters.

29. As for the nature of activities undertaken by IOS, I was pleased to note that it placed emphasis, in order of importance, on operational and compliance audits

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<sup>3</sup> Joint Inspection Unit report, JIU/REP/2005/6.

(47 per cent), investigative and fact-finding matters (13 per cent), as well as advisory activities (7 per cent). I also noted that IOS had since 2006 acted as the focal point within UNIDO for the Joint Inspection Unit of the United Nations System. In order to guard against compromising its independence when providing advisory services to management, IOS should take care not to become involved in the operational functions of UNIDO, except as described in its charter.

30. My review of the unit's time attendance records for the past three years, i.e. 2004 to 2006, revealed that the unit was consistently working at a rate in excess of 100 per cent of workable hours, with a notable increase in 2006. This higher rate of work was necessitated by, amongst other things, the need to respond to numerous *ad hoc* requests while still having to carry out its work plan, and as a result of vacancies. I also reviewed the budgetary resources allotted to IOS from the 2002-2003 biennium onwards. My review indicated that the budgeted staffing and official travel costs appear not to have increased commensurate with the higher level of auditable and related activities that flowed from the programme and budget of the organisation, which showed an increase over the same period.

31. In view of the developments mentioned in paragraph 30, the risk exists that IOS may not be able to effectively discharge its responsibility relating to UNIDO's internal control framework.

## **B. Implementation of International Public Sector Accounting Standards**

32. I took note of the IDB's decision at its thirty-second session regarding the adoption of the International Public Sector Accounting Standards (IPSAS). In this regard, the Board agreed, in principle, to the adoption of the IPSAS by UNIDO, as part of a United Nations system-wide adoption of IPSAS by 1 January 2010. In addition, the Board requested the Director-General to proceed with the assessment, planning and estimation of project costs for inclusion in the proposals for the programme and budgets for the biennium 2008-2009 and requested that the Member States be kept informed of the developments in the adoption of IPSAS.

33. I have since monitored the progress made through in-depth discussions with management. I also considered the note prepared by the Secretariat on IPSAS (PBC.23/8) and inspected the draft proposals for the programme and budgets for the biennium 2008-2009, which incorporate the IPSAS initiative in major programme G: support services and general management.

## VII. Conclusion

34. I am pleased to report that I continued to enjoy the full cooperation and support of management in discharging my duties as the external auditor to the organisation. I look forward to reviewing the implementation of my recommendations and monitoring future developments that affect the organisation.

*[Signature]*

**Terence Nombembe**

**External Auditor**

**Auditor-General of the Republic of South Africa**

**Pretoria, South Africa**

**16 March 2007**

ANNEX A

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

35. Below is a tabular inventory reflecting key recommendations from my report on the accounts of the organisation for the 2004-2005 financial period. These recommendations are at various stages of implementation. The matters that are not listed here were addressed to my satisfaction.

<b>Recommendations</b>	<b>PBC.22/3 reference</b>	<b>Secretariat's comments</b>	<b>Auditor's comments</b>
<b>Internal Oversight Services:</b>			
No activity has been recorded for some time on the IOS hotline since it was introduced in 1999 as a means for staff to communicate complaints or information concerning the possible existence of fraudulent activity, waste, abuse or other irregularities.	16	IOS is working on a hotline email address with a name independent of an organisational unit acronym. As soon as resources become available, a web-based reporting tool will be implemented, in cooperation with PSM/ICM.	The external auditor will keep the matter under review.
In compliance with IIA standards, an independent external quality assessment of IOS is required at least once every five years.	18	The assessment, which requires an important time investment by the unit, has been postponed to the first half of 2007, as unplanned and pressing priorities were given precedence in view of their potential impact on the organisation.	The external auditor will keep the matter under review.
<b>Non-expendable property:</b> The management of non-expendable property in the field is in need of some improvement.	30	Physical inventories of non-expendable property in the field for 2006 were being finalised and inventory records would be updated accordingly. It was expected that the issuance of the procedural documents, in combination with guidance provided by PSM/OSS/GES, would result in improvements in that area.	The external auditor will keep the matter under review.

Recommendations	PBC.22/3 reference	Secretariat's comments	Auditor's comments
<b>Procurement:</b>			
The procurement guidelines were in draft format.	34	It was foreseen that the UNIDO procurement manual would be issued in the first half of 2007.	The external auditor will keep the matter under review.
Procurement plans were incomplete and the organisation could enhance their use as management and monitoring tools.	36	Although a new procurement planning system was introduced in October 2006, the response rate of allotment holders in estimating procurement requirements for 2007 was low.	The external auditor will keep the matter under review.
Staff members involved in the procurement process were not required to make a declaration of any potential conflict of interest in carrying out their duties.	39	Although the matter was included in the draft procurement guidelines, it will be further considered at the next procurement workshop.	The external auditor will keep the matter under review.
<b>Information and communication technology (ICT):</b>			
Networks: The organisation has not implemented a security tool that would record and report on network security violations or incidents.	46	The LFX Process desk was acquired in 2005 and is currently being modified. The most current estimate for completion of its implementation was June 2007.	The external auditor will keep the matter under review.
Operating system and logical security: A number of shortcomings were identified in the operating system and logical access controls on the Windows NT server, particularly in the security settings.	47	It was foreseen that the automatic system log collection and analysis tool would be fully activated and serve as a feed of critical alerts into LFX Process desk by June 2007.	The external auditor will keep the matter under review.

Recommendations	PBC.22/3 reference	Secretariat's comments	Auditor's comments
<p><b>Environmental policy and management strategy:</b> UNIDO has not developed and implemented a formal environmental policy and management strategy.</p>	Annex 1	A UN system-wide policy did not exist. PSM/OMD has researched this area and collected information from within and outside the UN system to ensure the introduction of best practices.	The external auditor will keep the matter under review.
<p><b>End-of-service and after-service health insurance liabilities:</b> Budgetary provision has not 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.</p>	Annex 1	A UN system-wide solution was being sought to address the issue of unfunded liabilities. UNIDO was participating in the present common actuarial study by the UN and also requested the Joint Inspection Unit to find a system-wide solution to this issue.	The external auditor will keep the matter under review.