United Nations

United Nations Office for Project Services

Financial report and audited financial statements

for the biennium ended 31 December 2001 and

Report of the Board of Auditors

General Assembly
Official Records
Fifty-seventh Session
Supplement No. 5J (A/57/5/Add.10)

General Assembly
Official Records
Fifty-seventh Session
Supplement No. 5J (A/57/5/Add.10)

United Nations Office for Project Services

Financial report and audited financial statements

**for the biennium ended
31 December 2001 and**

Report of the Board of Auditors

United Nations • New York, 2002

Note

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

ISSN 1020-718X

[8 July 2002]

Contents

Letters of transmittal and certification

20 June 2002

We have the honour to submit the financial statements of the United Nations Office for Project Services (UNOPS) for the biennium ended 31 December 2001, which we hereby approve.

We, the undersigned, acknowledge that:

(a) The Management is responsible for the integrity and objectivity of the financial information included in this report;

(b) The financial statements have been prepared in accordance with the United Nations system accounting standards and include certain amounts that are based on Management's best estimates and judgements;

(c) Established accounting procedures and related systems of internal control provide reasonable assurance that assets are safeguarded, that the books and records properly reflect all transactions, and the policies and procedures are implemented by qualified personnel with an appropriate segregation of duties. UNOPS internal auditors continually review the full range of UNOPS activities and the related accounting and control systems;

(d) The Management provide the United Nations Board of Auditors and UNOPS internal auditors with full and free access to all accounting and financial records;

(e) The recommendations of the United Nations Board of Auditors and internal auditors are reviewed by the Management. Control procedures have been implemented or revised, as appropriate, in response to these recommendations.

We each certify that, to the best of our knowledge, information and belief, all material transactions have been properly charged in the accounting records and are properly reflected in the appended financial statements.

(*Signed*) Reinhart **Helmke**
Executive Director
United Nations Office for Project Services

(*Signed*) Martyn **Evans**
Assistant Director
Division for Finance, Budget and Administration
United Nations Office for Project Services

The Chairman of the
Board of Auditors
United Nations
New York

25 June 2002

I have the honour to transmit to you the financial statements of the United Nations Office for Project Services for the biennium ended 31 December 2001, which were submitted by the Executive Director. These statements have been examined and include the audit opinion of the Board of Auditors.

In addition, I have the honour to present the report of the Board of Auditors with respect to the above accounts.

(*Signed*) Shauket A. **Fakie**
Auditor-General of the Republic of South Africa
and Chairman
United Nations Board of Auditors

The President of the
General Assembly of
the United Nations
New York

Chapter I
Financial report for the biennium ended 31 December 2001

1. The Executive Director of the United Nations Office for Project Services (UNOPS) has the honour to submit his financial report for the biennium 2000-2001. The present report, together with the audited financial statements for the biennium ended 31 December 2001 also includes the report of the Board of Auditors. This submission is made in conformity with the United Nations Office for Project Services Financial Regulations and Financial Rules of the United Nations Development Programme (UNDP), which are applicable to the Office mutatis mutandis. The financial statements consist of three statements and two schedules, accompanied by notes which are an integral part of the financial statements, and cover all funds for which the Executive Director is responsible.

A. Accounting practices and policies

Accounting policies

2. A summary of significant accounting policies applied in the preparation of the financial statements is provided in note 2 to the financial statements. Overall policies are consistent with those applied in the 31 December 1999 financial statements. Changes in accounting policies, if any, are properly disclosed in the aforementioned note 2.

Presentation of financial statements

3. The financial statements have been prepared, in all material aspects, in accordance with the United Nations system accounting standards, with due consideration given to the fact that UNOPS is self-financed, that is, its administrative expenditures are financed by the income it earns.

B. United Nations Office for Project Services account

Table
Overview of financial results for the biennium ended 31 December 2001 with comparative figures for the biennium ended 31 December 1999 (millions of United States dollars)

	1998-1999	*2000-2001*
Delivery		
Projects	1 097.7	975.8
Services	371.0	388.0
Total	**1 468.7**	**1 363.8**
Income		
Project implementation	86.5	74.6
Loan administration and other services	10.1	13.6
Interest and other income	4.4	4.2
Savings from prior biennium	1.0	3.2
Total	**102.0**	**95.6**
Administrative expenditures		
Recurring operating costs	87.8	105.0
Non-recurring expenditures	18.2	3.0
Total	**106.0**	**108.0**
Opening balance on reserve/unspent income	21.4	17.4
Charge to operational reserve	(4.0)	(12.4)
Closing balance on operational reserve	17.4	5.0

4. As shown in statement I, in the biennium 2000-2001 ended 31 December 2001, UNOPS income from all sources totalled $95.6 million and its administrative expenditure reached $108.0 million. Therefore, in the biennium ended 31 December 2001, administrative expenditure exceeded income by a total of $12.4 million. $3.0 million of this excess of expenditure over income for the year 2000 was approved in advance by the Executive Board at the September 2000 session to complete the UNOPS investment in the implementation of the Integrated Management Information System (IMIS) and the upgrade of related systems. Comparative figures for the biennium ended 31 December 1999 for income and administrative expenditures were $102.0 million total income from all sources (including $1.0 million of savings on obligations from the prior period) and $106.0 million of administrative expenditure. In the biennium 1998-1999, the non-recurring investment expenditure covering the implementation of IMIS and the relocation of the New York headquarters totalled $18.2 million. In the biennium 1998-1999, the excess of total expenditure (both recurring and non-recurring) over total income therefore amounted to $4.0 million.

C. United Nations Office for Project Services income

5. Total income earned in the biennium ended 31 December 2001 of $95.6 million was earned as follows: $74.6 million, or 81 per cent of the total, from project implementation services; $13.6 million, or 15 per cent of the total, from services provided to the International Fund for Agricultural Development (IFAD) and other clients; $4.2 million, or 4 per cent of the total, from interest income and other sources. In addition there were savings from prior period obligations of $3.2 million giving a grand total of $95.6 million.

6. In the biennium 1998-1999, the equivalent total income amounted to $102 million. Income from projects amounted to $86.5 million, or 86 per cent of the total, with loan implementation and other services amounting to $10.1 million, or 10 per cent of the total, and interest and other income at $4.4 million or 4 per cent. In the biennium 1998-1999, the savings from prior period obligations totalled a further $1.0 million giving a grand total of $102 million.

1. Income from project implementation

7. The range of clients on whose behalf UNOPS undertakes project implementation is detailed in schedule I of the financial statements. UNOPS earned a total of $74.6 million from support costs and management fees during the biennium 2000-2001. The main elements of this income can be summarized as follows: $26.7 million, or 36 per cent of the total, from UNDP-funded projects; $15.1 million, or 20 per cent of the total, for management fees for projects funded under the management service agreement modality and $14.8 million, or 20 per cent of the total, from projects financed by UNDP-administered trust funds and $4.9 million, or 7 per cent, of the total, from services provided as either cooperating or associated agency.

8. UNOPS began implementing projects for other United Nations organizations in 1996, with 14 projects for five United Nations agencies. In the 1998-1999 biennium the total income from projects operated by UNOPS on behalf of other United Nations agencies (including the United Nations International Drug Control Programme (UNDCP)) went up to $7.0 million, while in the biennium 2000-2001, this increased significantly to $13.1 million. For the biennium 1998-1999, the $7.0 million represented 8 per cent of the income earned by UNOPS from implementing projects, while for 2000-2001 the equivalent $13.1 million was 18 per cent of the total UNOPS income from project delivery. This represents more than 290 projects on behalf of 33 United Nations clients and significant progress towards the portfolio diversification goal set for UNOPS by the Management Coordination Committee, the Advisory Committee on Administrative and Budgetary Questions and the Executive Board.

2. Income from the loan administration and project supervision of the International Fund for Agricultural Development and services provided to other organizations

9. In the biennium ended 31 December 2001 UNOPS earned a total of $12.2 million as compensation for loan administration and project supervision services provided to the International Fund for Agricultural Development (IFAD). This compares with $9.9 million for the biennium 1998-1999.

10. Under a cooperation agreement signed with IFAD, UNOPS, as a cooperating institution, provides loan administration and project supervision services for a portfolio of IFAD projects. As a loan administrator, UNOPS ensures that the procurement undertaken by the national entities implementing IFAD-funded projects conforms to the applicable procurement guidelines and subsequently reviews and approves the withdrawal applications submitted by Governments to draw funds from the loan account maintained by IFAD. As a supervisor of the implementation of IFAD projects, UNOPS undertakes project supervision missions to assess the status of project implementation, identify operations problems and propose corrective actions to be taken. As at 31 December 2001, UNOPS supervised a total of 115 projects and administered a loan portfolio of $2.3 billion.

11. Following authorization from UNOPS, in the biennium 2000-2001, IFAD paid $388 million in loan disbursements to suppliers of goods, services and works (including Governments). These disbursements do not pass through UNOPS accounts, since they are paid directly to these suppliers and, therefore, they are identified separately under the heading of service delivery.

12. UNOPS earned a total of $1.4 million in the biennium 2000-2001 from the provision of a range of advisory services to clients other than IFAD and accounting services to the Programme of Assistance to the Palestinian People. During the biennium 1998-1999, $0.2 million was earned from the provision of accounting services to the Programme.

3. Other income

13. During the biennium ended 31 December 2001, UNOPS also received other income totalling $4.2 million. This included a total of $1.1 million from the Governments of Austria, Denmark and Switzerland to defray costs associated with the relocation of the divisions to Copenhagen and Geneva, and the opening of the unit in Vienna. $1.9 million of interest was earned through the investment of the balance on the operating reserve. Income totalling a further $1.2 million was earned from travel rebates, rental of office space and other miscellaneous sources. In the biennium 1998-1999, total other income amounted to $4.4 million, of which $1.0 million came from the Governments of Denmark and Switzerland, $3.0 million in interest and $0.4 million from miscellaneous sources.

Administrative budget and expenditure of the United Nations Office for Project Services

14. At its third regular session, in September 2001, the Executive Board, in its decision 2001/14 approved the UNOPS revised budget estimates for the biennium 2000-2001 with total administrative expenditures at $110.6 million. As shown in schedule 2 to the financial statements, the Office incurred administrative expenditures totalling $108.0 million, $55.3 million in 2000 and $52.8 million in 2001. Schedule 2 also reflects costs totalling $1.1 million in the biennium 2000-2001 associated with the relocation of the Office to Copenhagen and Geneva and the opening of the office in Vienna. The contribution from the host Governments matched the costs associated with the relocation.

Operational reserve

15. The balance of the UNOPS operational reserve at 31 December 1999 was $17.4 million. In 2000, the drawdown against this reserve amounted to $6.8 million of which $3.0 million had been approved as non-recurring information systems investment during the Advisory Committee on Administrative and Budgetary Questions/Executive Board budget review in September 2000. The balance of $3.8 million resulted from the excess of operating expenditure over income in 2000. In 2001 operating expenditure exceeded income by $5.6 million and this shortfall was taken as another drawdown against the operational reserve. The balance on the operational reserve at 31 December 2001 was therefore $5.0 million.

16. In its decision 2001/14 of September 2001 the Executive Board approved the proposal to change the basis for the calculation of the level of the UNOPS operational reserve to 4 per cent of the rolling average of the combined administrative and project expenditures for the three previous years. On the basis outlined in that decision, at 31 December 2001, the balance on the operational reserve should be $23.1 million, a shortfall of $18.1 million.

Ex gratia payments and write-offs of cash and receivables

17. One write-off case in the amount of $0.2 million was recorded and no ex gratia payments were made during the biennium ended 31 December 2001.

Project expenditures (United Nations Office for Project Services delivery)

18. In the biennium 2000-2001, UNOPS delivered project expenditures, excluding support costs and management fees, totalling $975.8 million, while for the biennium 1998-1999 the equivalent total was $1,097.7 million. The 2000-2001 delivery represents $121.9 million, or an 11 per cent decrease over the value delivered in the biennium 1998-1999.

Projections of the Office’s portfolio, income and administrative expenditures and income

19. As a result of the difficult two years evidenced in the results for the biennium 2000-2001, UNOPS approached the business planning for the critical year of 2002 with a more detailed and thorough process. In February 2002, a task force was established by the Deputy Executive Director/Director of Operations to collect and analyse unit budgets for 2002, define and evaluate priorities for activities and resources requested by units and catalogue, prioritize and recommend measures to increase income or reduce costs. The report of the task force was used as a basis for a comprehensive planning exercise for 2002 undertaken by an Executive Group selected and chaired by the Executive Director of UNOPS.

20. The Executive Group developed and applied criteria in the business-driven review of operations and support divisions that would result in concentrating resources to: (a) directly and immediately contribute to delivery and generation of income; (b) maintain the minimal corporate support necessary for control and assurance purposes; and (c) establish a framework for a sustainable UNOPS in 2003 and beyond.

21. The report of the Executive Group, which was issued to staff and the UNOPS Management Coordination Committee, identified a total project delivery of $500

million generating an estimated income for 2002 of $36.1 million, a further $7.6 million for the provision of services and $0.5 million from other miscellaneous sources. This gives a total forecast income for 2002 of $44.2 million. The total administrative expenditure forecast by the Executive Group amounts to $47.1 million thus giving a shortfall $2.9 million. The forecast total administrative expenditure includes savings against the original unit budget submissions of $6.9 million analysed between $2.9 million from non-personnel reductions and $4.0 million from personnel-related costs. The $47.1 million administrative expenditure total does not include any costs associated with staff termination. These will be funded as per the Financial Regulations and Rules from the UNOPS operational reserve. The report of the Executive Group was presented to the Management Coordination Committee and formed the basis for an informal session with the Executive Board.

22. A Management Coordination Committee working group was established on 19 April, in line with the recommendations of the Secretary-General and a decision of the Executive Board. This working group, which includes a representative from each Management Coordination Committee member's organization and UNOPS, is co-chaired by representatives of UNOPS and the Chairman of the Management Coordination Committee. The first task of the group was to work together to find ways to reduce UNOPS 2002 expenditures to $43 million, in line with the cap set by the Management Coordination Committee at its 19 April meeting. The group produced an interim report, which was discussed at a meeting of the Committee held on 30 May. The working group undertook a division-by-division and line-by-line review of the April Executive Group budget proposal of $47.1 million. It recommended a revised budget cap of $44 million and identified and recommended a first set of reductions totalling $1.2 million in non-staff operating costs. In addition, the management of UNOPS identified a further $0.7 million in reductions through measures including freezing some vacancies, supporting staff who were interested in taking mission assignments, and voluntary special leave without pay. UNOPS management then worked with divisions to find still another $1.2 million in cost reductions, mostly through cuts in short-term personnel. These three rounds of reductions together enabled UNOPS to cut a total of $3.1 million from the April budget proposal of $47.1 million, resulting in the achievement of the Management Coordination Committee working group's $44 million budget goal for 2002. UNOPS revised 2002 income projection has been substantiated by the Executive Group and subsequently confirmed through the Management Coordination Committee working group. Targets were based in part on assumptions of $503.2 million in project delivery in 2002, $35.4 million in project income, and $8.9 million in other income. The projected total income for UNOPS in 2002 is therefore $44.3 million.

Chapter II
Report of the Board of Auditors

Summary

The Board of Auditors has reviewed the operations of the United Nations Office for Project Services (UNOPS). The Board has audited the financial statements for the biennium ended 31 December 2001.

The Board's main findings are as follows:

(a) The Board has modified its opinion in view of the financial position of UNOPS and its ability to fund in full any deficit from the operational reserve. A further significant shortfall in income could lead to the exhaustion of the operational reserve, especially since UNOPS is not budgeting for a surplus, but rather, to break even in 2002;

(b) UNOPS acknowledges that it may need to take further measures, should the amount of its deficit exceed the level of its operational reserve. However, the Office did not have a contingency plan on measures to be taken in the event that the 2002 operations result in a deficit which cannot be absorbed by the remaining balance of the operational reserve;

(c) Actual project delivery for the biennium 2000-2001 has been less than the forecast project delivery by some 19 per cent, while actual project delivery for the biennium 1998-1999 was in line with projections. The related actual project income for the biennium 2000-2001 was less than the forecast project income by 17 per cent, while for the biennium 1998-1999, the actual project income exceeded forecast project income by some 6 per cent;

(d) The changes in administration cost structures, as well as changes in project management hours, have resulted in the project management officer workload system being unable to accurately compute and monitor the real cost of executing each project;

(e) As compared to the prior biennium, recurrent administrative expenditure had increased significantly by some 20 per cent to a level of $105 million for the biennium 2000-2001, while income decreased. UNOPS 2000-2001 administrative costs were not commensurate with project and other service income;

(f) UNOPS opted to set a target of $503.2 million which included some $13.2 million worth of project delivery with a moderate to high risk;

(g) Separation costs estimated at $2.2 million would effectively reduce the present operational reserve to $2.8 million. In addition, separation costs have not been finalized and would impact directly on operational reserves since these costs have not been provided for elsewhere;

(h) The Board is concerned that UNOPS may not cover all its proposed administrative expenditure budget of $45.3 million (capped at $44 million) with the projected level of income. UNOPS has informed the Board that it has prepared a proposed budget for 2002 of $44 million which will be submitted through the Management Coordination Committee to the Executive Board for approval;

(i) UNOPS has estimated the future value of after-service health insurance benefits amounting to $38.7 million. The balance is not funded.

The Board made recommendations on continued diversification of the business portfolio within the United Nations system, establishment of a reliable system for computing and monitoring costs, the exercise of caution in budgetary estimates and development of a contingency plan to address measures to be taken in the event further deficits cannot be funded from the operational reserve.

A list of the Board's main recommendations is included in paragraph 11 of the present report.

A. Introduction

1. The Board of Auditors has audited the financial statements of the United Nations Office for Project Services (UNOPS) for the biennium 2000-2001. The audit was conducted in accordance with article XII of the Financial Regulations of the United Nations and the annex thereto, and the common auditing standards of the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency. These standards require that the Board plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement.

2. The audit was conducted primarily to enable the Board to form an opinion as to whether the expenditures recorded in the financial statements for the biennium 2000-2001 had been incurred for the purposes approved by the governing bodies, whether income and expenditure had been properly classified and recorded in accordance with the Financial Regulations and Rules and whether the financial statements of UNOPS presented fairly the financial position as at 31 December 2001. The audit included a general review of financial systems and internal controls and a test examination of accounting records and other supporting evidence, to the extent the Board considered necessary to form an opinion on the financial statements. The Board has modified its opinion to emphasize its concern regarding the significant risk that may cause UNOPS to curtail its operations, as disclosed in note 15 to the financial statements. In addition, the operational reserve as at 31 December 2001 was not at the level required by the Executive Board.

3. In addition to the audit of the accounts and financial transactions, the Board carried out reviews under article 12.5 of the Financial Regulations of the United Nations. The reviews primarily concerned the efficiency of financial procedures, the internal financial controls and, in general, the administration and management of UNOPS. In the biennium 2000-2001, the Board focused primarily on the ability of UNOPS to continue at the present level of operations.

4. The Board continued its practice of reporting the results of specific audits in management letters, providing detailed observations and recommendations to management.

5. The present report covers matters that, in the opinion of the Board, should be brought to the attention of the General Assembly. The Board's observations on all matters contained in the present report were communicated to UNOPS, which has confirmed the facts upon which the Board's observations and conclusions are based and has provided explanations and answers to the Board's queries.

6. A summary of the Board's recommendations is contained in paragraph 11 below. Detailed findings are in paragraphs 13 to 93.

7. The General Assembly, in its resolution 52/212 B of 31 March 1998, accepted the recommendations of the Board of Auditors for improving the implementation of those of its recommendations approved by the Assembly, subject to the provisions contained in the resolution. The Board's proposals, which were transmitted to the General Assembly in a note by the Secretary-General (A/52/753, annex), included the following main elements:

(a) The need for specification of timetables for the implementation of recommendations;

(b) The disclosure of office-holders to be held accountable;

(c) The establishment of an effective mechanism to strengthen oversight in regard to the implementation of audit recommendations. Such a mechanism could be in the form of either a special committee comprising senior officials or a focal point for audit and oversight matters.

8. The Board noted that UNOPS had generally complied with the above-mentioned requirements.

1. Previous recommendations not fully implemented

9. In accordance with section A, paragraph 7, of General Assembly resolution 51/225 of 3 April 1997, the Board had reviewed the action taken by UNOPS to implement the recommendations made in its report for the biennium ended 31 December 1997[1] and earlier, and confirms that there are no outstanding matters.

10. In accordance with General Assembly resolution 48/216 B of 23 December 1993, the Board also reviewed the measures taken by UNOPS to implement the recommendations made in its report for the biennium ended 31 December 1997. Details of the action taken and the comments of the Board are set out in annex I to the present report.

2. Main recommendations

11. **The Board recommends that UNOPS:**

(a) Prepare a contingency plan to be submitted to the Executive Board for approval, to address measures to be taken in the event of the operational reserve being unable to absorb possible deficits (para. 77);

(b) Exercise caution in its budgetary assumptions and income projections to ensure that realistic targets are established (para. 22);

(c) (i) Continue to review its medium term-strategy in a comprehensive manner, including such elements as an analysis of the variables related to business from UNDP with a view to aligning its project delivery approach; and (ii) embark on a strategy to further diversify its client base within the United Nations system (para. 26);

(d) Evaluate the basis and calculation of the cost of services with a view to ensuring that all costs are identified and recovered, and that it ensure that the piloted system addresses all shortcomings identified in the project management officer workload system (para. 32);

(e) Review the funding mechanism and targets for end-of-service benefits. Owing to the unique funding principles of UNOPS, the Board considers that the Office may need to expedite its consideration of funding the end-of-service liabilities (para. 53);

(f) Evaluate its procedures for controlling costs, with a view to meeting project delivery needs, while ensuring flexibility to adapt to increases in the level of service delivery (para. 39);

---

[1] *Official Records of the General Assembly, Fifth-third Session, Supplement No. 5J* (A/53/5/Add.10).

(g) Continuously monitor actual performance against clearly defined targets and assess the specific methods to restore the operational reserve to its required level (para. 47);

(h) Consider presenting to the Executive Board for approval variable budgets based on several levels of activity, clearly identifying the most likely level of activity (para. 59);

(i) Compile a clear and definite action plan on how, where and when staff savings will be made and monitored; costs should be closely monitored and a revised submission made through the Management Coordination Committee to the Executive Board in order to obtain approval, should it become evident that the required level of administrative expenditure will be exceeded (para. 67).

12. The Board's other recommendations are contained in paragraphs 43, 49, 51, 62, 73, 79, 87, 90 and 92.

B. Background

13. The United Nations Office for Project Services was a division of the United Nations Development Programme (UNDP) until 1994. In its decision 48/501 of 19 September 1994, the General Assembly approved the establishment of the United Nations Office for Project Services in order to consolidate United Nations project management and help UNDP to focus on its mandate as the central funding and coordinating body for operational activities. UNOPS was formed to be totally self-financing and receives no financial contributions, but earns its fees by charging other United Nations organizations (UNOPS clients) for services rendered. These services include project management, selecting and hiring project personnel, procuring goods, organizational training, managing financial resources and administering loans.

14. The Executive Board, being an intergovernmental body of the General Assembly, overviews the results of UNOPS, particularly from a point of view of the donors. A Management Coordination Committee was established pursuant to a report of the Secretary-General[2] and by Executive Board decision 94/32. The Committee is chaired by the Administrator of UNDP and the other members are from the Department of Management, the Department of Economic and Social Affairs and UNOPS. The Management Coordination Committee provides policy and management direction and ensures transparency of UNOPS operations. The Secretary-General proposed that the Committee should expand its current members by inviting representatives of a few of UNOPS major clients in the United Nations system to participate in its proceedings. The Board was pleased to note that the first meeting of the expanded Management Coordination Committee was held on 18 June 2002.[3] A working group consisting of one representative of each of the members of the Committee was established in April 2002 to assist the Committee in its work, which specifically included assisting UNOPS in revising its 2002 budget.

---

[2] DP/1994/52.

[3] DP/2002/CRP.5.

15. The Secretary-General, in a note, dated 25 January 2002, on the relationship between UNDP and UNOPS,[3] outlined the role of UNOPS in the United Nations system and reiterated his support for its continued work as a “separate and identifiable entity that is self-financing”, as originally intended by Member States. He added that if UNOPS were to continue to meet its key objective of being self-financing, it was essential that it receive sufficient business from organizations in the United Nations system. He therefore encouraged all United Nations entities — starting with components of the Secretariat — to avail themselves of the services of UNOPS as long as that option remained cost-effective, although there was no obligation on the part of United Nations organizations to work through UNOPS.

C. Financial issues

16. UNOPS has prepared its financial statements according to United Nations system accounting standard 4 on the basis that the organization has neither the intention nor the necessity to curtail materially the scale of its operations, since it is a going concern. UNOPS, under the guidance of the Management Coordination Committee and its working group, has made significant efforts to achieve an improved financial position in 2002 and to at least move from a significant deficit of $12.4 million (after savings on prior period obligations) in 2000-2001 to breaking even in 2002. Signed contracts on the funds control system on 14 June 2002 show that UNOPS has $707 million worth of project portfolio available for implementation for 2002, as well as having $274.3 million for future years. However, the Board is concerned that if UNOPS does not break even in 2002, as is being budgeted for, there is a possibility that the low level of its operational reserve of some $5 million may not enable it to absorb the resulting deficit. There is a significant risk that both internal and external factors could influence the achievements on which forecasts and projections are based. Although UNOPS is a self-financing entity, it may not borrow funds nor have “working capital” to bridge resource requirements, if the need arises, and has to rely on its operational reserve for this purpose. Consequently, owing to a material uncertainty, there is the potential for a curtailment of operations.

1. Financial overview

17. UNOPS incurred a deficit of $15.6 million for the biennium 2000-2001, (including non-recurrent authorized expenditure of $3 million) before savings on prior period obligations of $3.2 million, which results in a net deficit of $12.4 million. Income for the biennium decreased by 9 per cent to $92.4 million, compared to $101 million in the biennium 1998-1999. Total administrative expenditure amounted to $108 million in 2000-2001, compared to $106 million in the biennium 1998-1999. However, recurrent expenditure amounted to $105 million, compared to $87.8 million in the biennium 1998-1999, representing an increase of some 20 per cent. The deficit resulted in a reduction of the operational reserve from $17.4 million in the biennium 1998-1999 to $5 million in the biennium 2000-2001. The deficit was primarily caused by a reduction in project delivery and related income with a simultaneous increase in recurrent administrative expenditure.

2. Project income

18. Project income remains the main source of income of UNOPS, representing some 81 per cent of total income of $92.4 million in the biennium 2000-2001, compared to 86 per cent of the total income for the biennium 1998-1999.

Actual versus forecast project delivery and related income

19. Income is earned by delivering project implementation services and other services such as loan administration. UNOPS charges a percentage of project delivery as support cost income. The income per category is indicated in annex II. The UNOPS budget for any year is revised annually and the Executive Board approved the revised budget for 2001 on 13 September 2001. As shown in annex II, actual project delivery was lower than forecast project delivery for the past five years, with the exception of 1999. (In 1997, it was $36.9 million lower; in 1998, $12.2 million lower; in 1999, $9.9 million higher; in 2000, $118.9 million lower; and in 2001, $111.3 million lower.) The difference between the forecast project income and the actual project income for the past five years is also shown in annex II. The Board noted that 1998 and 1999 were the only years in which actual project income exceeded forecast project income by $5.3 million and $0.1 million, respectively. For 1997, 2000 and 2001, actual project income was lower than forecast project income by $0.3 million, $5.9 million and $9.5 million, respectively.

20. **Actual project delivery for the biennium 2000-2001 was less than that forecasted by some 19 per cent while, simultaneously, actual project income was less than that forecasted amount by some 19 per cent. Actual delivery for the biennium 1998-1999 approximated the forecasted project delivery, while related actual project income exceeded the projected amount by some 6 per cent.**

21. Total income consists of project income, service income and other income (including savings on prior period obligations). Annex II also shows the relationship between forecast income and actual total income for the period from 1997 to 2001. The actual total income exceeded the total forecast income by $5.6 million in 1998 and by $0.8 million in 1999. Total actual income was lower than the total forecasted income by $0.1 million in 1997, $3.1 million in 2000 and $9.6 million in 2001.

22. **The Board recommends that UNOPS exercise caution in its budgetary assumptions and delivery projections to ensure that realistic targets are established.**

Client portfolio

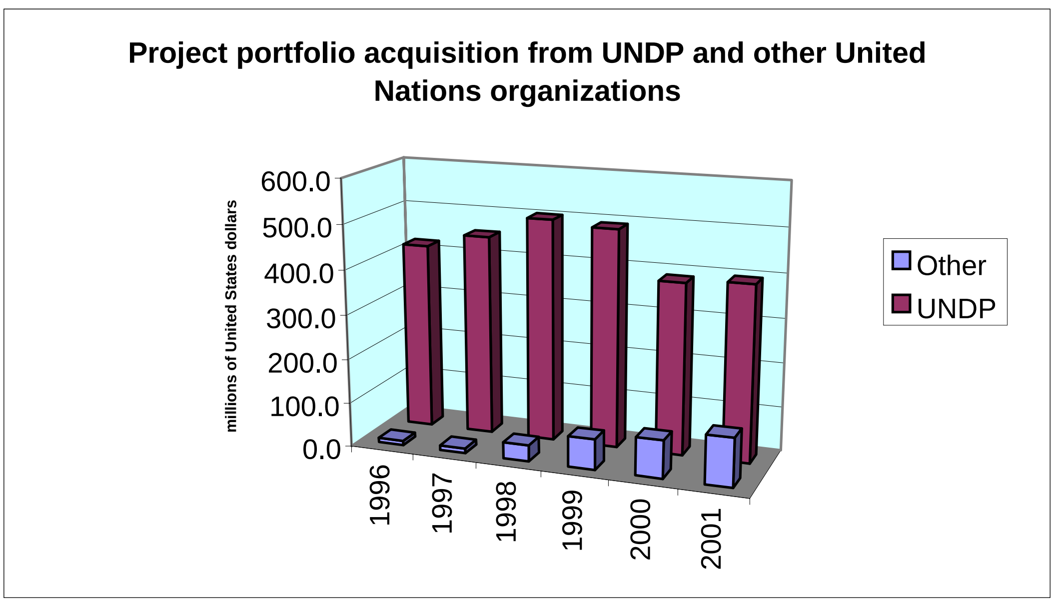
23. UNOPS enters all projects for which signed project documents have been attained on the funds control system. As at 14 June 2001, the total cumulative project value for 2002 is $981 million. The cumulative project values at the end of 1999, 2000 and 2001 were $1,520 million, $1,493 million and $1,411 million, respectively. The Board noted that actual project delivery for 1999, 2000 and 2001 was $560 million (37 per cent), $471 million (32 per cent) and $505 million (36 per cent), respectively. UNOPS forecasted delivery for 2002 was $503 million (52 per cent), although the total cumulative project value could increase further during the year and therefore decrease the rate of actual delivery to cumulative project values. UNOPS also indicated to the Board that it had further accepted projects with a value

of some $98 million for 2002, although these had not been entered in the funds control system at the time of the audit.

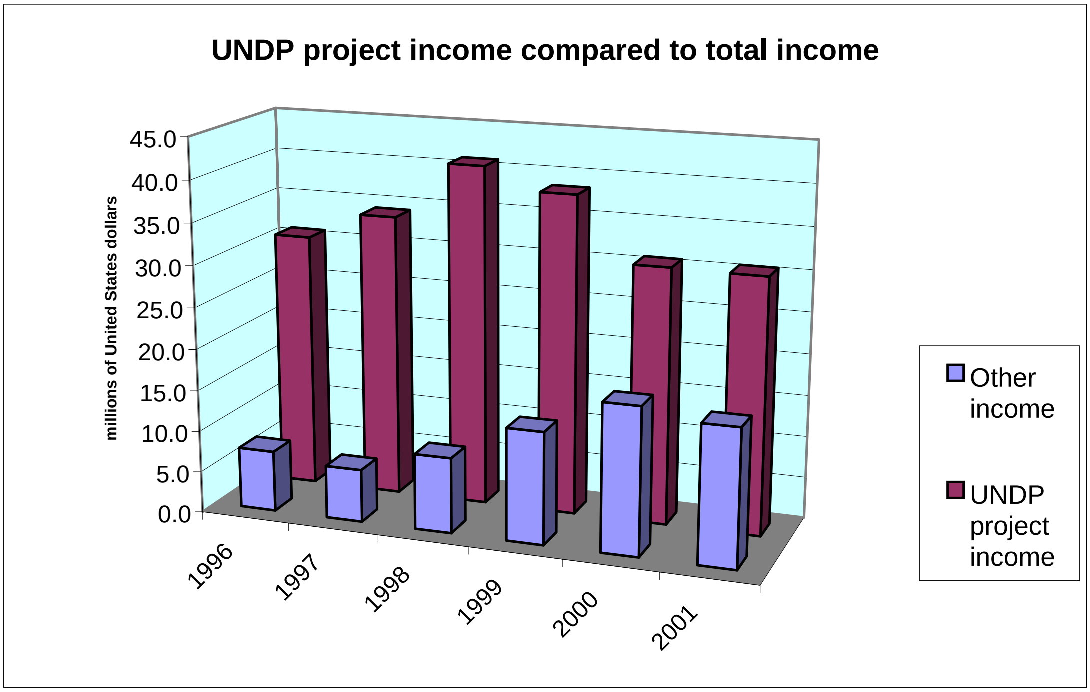
24. The Board considers that the financial position of UNOPS could be improved if those accepted projects were to be delivered while the related administrative costs are simultaneously contained within reasonable levels.

25. UNDP continues to be the largest client of UNOPS since the latter's inception. Income earned from UNDP is in the form of project income. UNOPS had started to diversify its service delivery to other United Nations organizations since 1996 in order to fulfil its mission of being a service provider to the entire United Nations system while simultaneously reducing its dependency on any one client or service. Income from UNDP decreased from $79.4 million (23 per cent) in the biennium 1998-1999 to $61.5 million in the biennium 2000-2001. Income from UNDP represented some 92 per cent of total project income of $86.4 million in the biennium 1998-1999, compared to 82 per cent in the biennium 2000-2001, when total project income amounted to $74.6 million. The Board recognized that the preferred modality of UNDP for project implementation in recent years was national execution and, to a lesser extent, direct execution. This was partly the reason for the decrease in projects entrusted to UNOPS. The UNOPS project portfolio is illustrated in graph 1. The project income from UNDP also represented some 67 per cent of total UNOPS income in the biennium 2000-2001, compared to 79 per cent in the biennium 1998-1999. Graph 2 below illustrates the UNDP share of UNOPS income, compared to other sources.

Graph 1
United Nations Office for Project Services project portfolio



Graph 2
Income from the United Nations Development Programme, compared to other income



26. **The Board recommends that UNOPS: (a) continue to review its medium-term strategy in a comprehensive manner, including such elements as an analysis of the variables related to business from UNDP, with a view to aligning its project delivery approach; and (b) embark on a strategy to diversify fully its client base within the United Nations system through assistance from appropriate senior levels of each potential client organization and the Management Coordination Committee.**

Project cost recovery and income rates

27. The Secretary-General stated in paragraph 6 of his note dated 25 January 2002,[3] that, in order to preserve the self-financing nature of its mandate, it is essential that the services provided by UNOPS are made on a reimbursable basis at the full cost of those services.

28. UNOPS uses a project management officer workload system to calculate the estimated cost of delivering services. An amount is then added by the system based on built-in assumptions to cover the level of central service support to the project management officer in relation to their workload from which UNOPS derives the income rate to be charged. The Board considers that it would be prudent for UNOPS to add a fixed margin on the full costs of a project to provide for risks and contribution to the operational reserve while ensuring they remain cost-effective.

29. UNOPS performed a review of the project management officer workload system late in 1999. The Board noted the following from the results of that review:

(a) Fees and support costs are calculated assuming that project management costs are proportional to the time the project management officers spend on it;

(b) The annual cost is calculated by dividing the annual administration cost by the number of project management officer-months actually worked and multiplying the result by the number of months spent on each project per year;

(c) The system was developed in 1987 (when UNOPS was still part of UNDP) and, as the portfolio of UNOPS grew and changed, little was done to adapt the system to changes in portfolio and management methods.

30. UNOPS indicated that the project management officer workload system assumptions had not been revised since 1997. **Changes in administrative cost structures, as well as changes in project management hours have resulted in the workload system being unable to accurately compute and monitor the real cost of executing each project.** The Board is pleased to note that a new system of calculating the cost of services was being piloted in the UNOPS Geneva office.

31. The actual rate of project income as a percentage of project delivery was 7.5 per cent in 2001, which was 0.2 per cent lower than the budgeted rate of 7.7 per cent, or a reduced income of some $1 million. The Board noted that different rates are charged for different projects and clients, with the maximum rate being 10 per cent for some UNDP projects funded under regular resources, depending on the estimated costs to be incurred. The project income as a percentage of project delivery, excluding other services, for the past years is depicted in table 1 below. The table reflects that the rate of project income peaked in 1998 but dropped to 7.5 per cent in 2001. The combined effect of lower delivery with a corresponding drop in the project income rate resulted in a significant reduction in project income.

Table 1
Project income as a percentage of project delivery
(in millions of United States dollars)

Year	*Project delivery*	*Project income*	*Percentage*
1996	430.8	31.6	7.3
1997	463.1	35.0	7.6
1998	537.8	43.5	8.1
1999	559.8	43.0	7.7
2000	471.1	36.8	7.8
2001	504.7	37.9	7.5

32. **The Board recommends that UNOPS evaluate the basis and calculation of the cost of services, with a view to ensuring that all costs are identified and recovered while ensuring that they remain cost-effective and that the piloted system addresses all shortcomings identified in the existing project management officer workload system. Furthermore, UNOPS should consider the feasibility of using a fixed margin to be able to better control fluctuations in cost recovery rates, while ensuring it remains cost-effective.**

33. The Board noted that, according to UNOPS internal minutes and a report prepared by a consulting firm, delivery was impacted by the economic downturn and

political instability in a number of countries where UNOPS operates and that some of the consequences were beyond its control.

3. Administrative expenditure

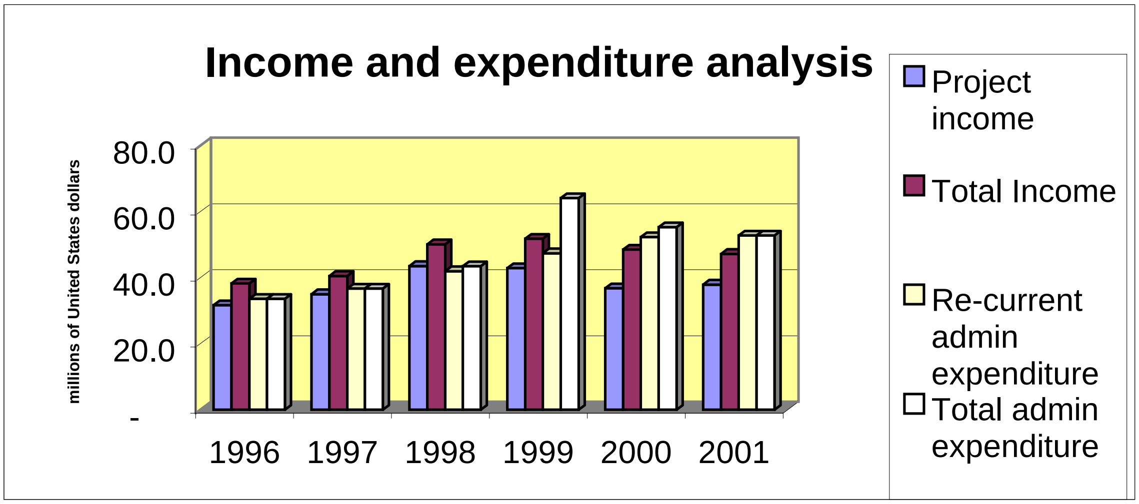
34. Total administrative expenditure for the biennium was $108 million, as detailed in annex IV. The administrative expenditure includes an amount of $3 million in respect of non-recurrent information systems costs for which the Executive Board’s prior approval was obtained to charge directly against the operational reserve. An analysis in graph 3 reflects the relationship between the project income, total income, recurrent administrative expenditure and total administrative expenditure.

35. The total administrative expenditure increased by 2 per cent, from $106 million in the biennium 1998-1999 to $108 million in the current biennium. Non-recurrent costs amounting to $18.2 million were included in the $106 million for the biennium 1998-1999: $14.1 million was incurred in the relocation of UNOPS headquarters to the Chrysler building and $4.1 million related to the implementation of the Integrated Management Information System (IMIS). The Board had reported on these costs in its previous report.[4] **If these non-recurrent costs are excluded, recurrent administrative expenditure increased by 20 per cent, from $87.8 million in the biennium 1998-1999 to $105 million (excluding a non-recurrent information system cost of $3 million) in the biennium 2000-2001.** The majority of the increase in the biennium 2000-2001 is due to an 18 per cent increase in salaries and wages to $47.3 million, a 27 per cent increase in common staff costs to $17.9 million and a 50 per cent increase in general operating expenditure to $13.5 million.

[4] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 5J* (A/55/5/Add.10).

Graph 3

Analysis of project income, total income, recurrent administrative expenses and total administrative expenses



36. In its previous report,[4] the Board made detailed observations regarding the relocation of UNOPS from the Daily News and 820 Second Avenue buildings and its concern that the relocation cost of $14.1 million in 1998-1999 had exceeded the original estimated costs of $7.3 million. The lease for space in the Chrysler building is for three five-year terms. The monthly rental for the office space in the Chrysler building amounts to $301,200, $309,600 and $320,300 for 2000, 2001 and 2002, respectively, therefore resulting in a cost of $7.3 million for the biennium 2000-2001.

37. UNOPS provided the Board with information comparing its present rental costs to the costs that it would have incurred in its previous locations. The combined market-related rate of these two premises would have amounted to $261,000 per month compared to the Chrysler building, with an average cost of $305,400 per month for the biennium 2000-2001. The total space leased by UNOPS amounted to 74,916 square feet in its previous locations, compared to the current 79,615 square feet currently occupied (some 5,100 square feet more) in the Chrysler building. Therefore, UNOPS rental costs for the biennium 2000-2001 were some $1.07 million higher than what they would have been in the premises previously occupied.

38. The high administrative cost was an indication that the UNOPS administrative core, based on forecasted project delivery of $616 million in 2001, had increased disproportionately in relation to the level of project delivery which averaged $494.6 million per year for the period from 1996 to 2001. The average project income over the same period amounted to $38 million (7.7 per cent), indicated in annex V. As shown in annex II, UNOPS actual recurrent administrative expenditure was consistently less than the budgeted recurrent administrative expenditure, with the exception of 2000, when actual administrative expenditure exceeded the budgeted amount by $0.7 million. The difference between the actual recurrent administrative expenditure and budgeted recurrent administrative expenditure is as follows: 1997, $1.8 million; 1998, $1.6 million; 1999, $0.7 million; and 2001, $2.5 million. The

Board is concerned that, for the biennium 2000-2001, **UNOPS administrative costs were not aligned to project and other service income**.

39. **The Board recommends that UNOPS evaluate its procedures for controlling costs, with a view to meeting project delivery needs, while ensuring flexibility to adapt to increases and decreases in the level of service delivery.**

4. Budget revisions (2001)

40. The Executive Director presented to the Executive Board, in September 2001, a revised budget for 2001 based on actual financial data as at the end of June 2001. The revised budget reflected increases in income of $5.2 million and administrative expenditure of $3.7 million with a projected surplus of $1.5 million. However, this projected surplus was higher by $7.1 million from the actual deficit in 2001. Table 2 below outlines the revisions.

Table 2
Comparison of original and revised budget to actual
(in millions of United States dollars)

	First revised budget 2001	*Latest budget 2001*	*Difference*	*Actual 2001*	*Variance between actual and revised*
Project delivery	590.0	616.0	26	507.0	109
Project income	42.7	47.4	4.7	37.9	9.5
Services and other income	8.9	9.4	0.5	9.3	0.1
Total income	51.6	56.8	5.2	47.2	9.6
Total expenses	(51.6)	(55.3)	3.7	(52.8)	2.5
Surplus (deficit)	**0**	**1.5**	**1.5**	**(5.6)**	

41. The Board noted that the actual financial position at the end of June 2001 as per the UNOPS financial system was as follows: project delivery was $287.3 million, project income was $21.5 million, other income was $4.3 million and administrative expenses were $23.7 million.

42. A basic extrapolation of the financial performance for the first six months of 2001 with the addition of annual administrative costs which were not yet incurred by June (for example, taxes) would have indicated project delivery of $574 million and a resulting shortfall of $1.5 million. The Operations Review Group, which focuses on operational issues affecting UNOPS, meets twice monthly. According to the minutes of the Group's meeting of 2 August 2001, actual delivery at 31 July 2001 was a cumulative amount of $302.4 million. The Group concluded that a monthly delivery of approximately $63 million was required from August 2001 to meet the target for 2001, which had been set at $616 million. The Board is therefore concerned that the budget assumptions related to project delivery in 2001 were overly optimistic, even though UNOPS had managed to somewhat curb recurrent administration expenditure by some $2.5 million, as reflected in annex II.

43. **The Board recommends that UNOPS prepare budgets and revisions thereto on a basis which is more in line with realistic project delivery.**

5. Operational reserve

44. UNOPS regulation 8.3 provides that an operational reserve shall be established at a level approved by the Executive Board . The operational reserve may be utilized for:

(a) Shortfall in income;

(b) Uneven cash flow;

(c) Professional or contractual liabilities associated with UNOPS services;

(d) Liabilities associated with UNOPS personnel contracts financed from the UNOPS account.

45. In its decision 98/20 of 21 September 1998, the Executive Board approved a budget for the biennium 1998-1999, which projected that UNOPS would not generate sufficient income in the biennium to cover the full costs of introduction and implementation of IMIS or the relocation of its headquarters premises. The Executive Board agreed to fund these costs, which were estimated at $11.4 million, from the operational reserve, insofar as they were not covered by income. The Executive Board also approved a reduction of the operational reserve to $11.2 million at 31 December 1999. The reserve balance as at the end of December 1999 was, in fact, $17.4 million, owing to the fact that surplus income over expenditure was higher than originally forecasted. At the end of 1999, UNOPS forecasted that the reserve would increase to a level of $22.6 million at 31 December 2001, and expressed its intention to restore the reserve to the prescribed level in the biennium 2002-2003. In the course of the Board's interim audit in September 2001, UNOPS provided information projecting that its operational reserve would amount to $14.3 million at the end of the biennium 2000-2001 in line with the report of the Executive Director containing the revised budget estimates for the biennium 2000-2001.[5] In its decision 2001/14 in September 2001, the Executive Board approved the proposal to change the basis for the calculation of the level of the UNOPS operational reserve to 4 per cent of the rolling average of the combined administration and project expenditures for the three previous years, which would imply a level of $23.1 million at the end of December 2001. The actual level of the reserve as at 31 December 2001 of some $5 million is $18.1 million lower than the required level following an operating deficit of $15.6 million (prior to savings on prior period obligations of $3.2 million). Annex V reflects the movements in the operational reserve since 1996. The operational reserve is backed by short-term investments in call accounts.

46. The Board is concerned that **this decreasing trend could lead to the exhaustion of the operational reserve, especially since UNOPS is not budgeting for a surplus, but to break even in 2002**. UNOPS would therefore not have the financial resources needed to bridge difficult periods in future.

47. **The Board recommends that UNOPS continuously monitor actual performance against clearly defined targets and assess the specific methods to restore the operational reserve to its required level. The Board further recommends that UNOPS communicate such performance and measures taken to the Executive Board.**

[5] DP/2000/37.

6. Unliquidated obligations

48. As per note 13 of the financial statements, total unliquidated obligations amounted to $31.3 million. Of this amount, $7.3 million (23 per cent) related directly to UNOPS own expenditure accounts. The Board noted that only $0.81 million of such unliquidated obligations were liquidated as at 31 May 2002. The Board noted that UNOPS reviews unliquidated obligations in May, August and November of each year. UNOPS indicated that, as at 31 May 2002, based on its first review, less than $62,000 of these unliquidated obligations would be cancelled. In view of the present financial situation, the Board is of the opinion that a more regular review of unliquidated obligations could have enabled UNOPS to cancel invalid ones during the biennium 2000-2001 and thereby improve its financial position at year-end.

49. **While the Board recognizes the efforts made by UNOPS to review unliquidated obligations, it recommends that UNOPS conduct more regular reviews of all unliquidated obligations in a timely manner.**

7. Other sources of income

50. UNOPS earns fees from the Rome-based International Fund for Agricultural Development (IFAD) for services it provides in respect of loan administration and project supervision. This is the second largest source of income for UNOPS. In the biennium 2000-2001, UNOPS earned $12.2 million, compared to $9.9 million in the biennium 1998-1999. Schedule 2 of the financial statements indicates costs of $1.9 million and $1.3 million incurred against these earnings in the bienniums 2000-2001 and 1998-1999, respectively. UNOPS supervised a total of 115 projects and administrated a loan portfolio of $2.3 billion, as at 31 December 2001. The Board noted that:

(a) The specific expenditure disclosed in the financial statements included only travel and accommodation, and consultants’ fees;

(b) UNOPS maintains an office in Rome in respect of IFAD services and IFAD projects are visited regularly by UNOPS staff. The expenditure which has been disclosed does not include the costs associated with salary and overheads of UNOPS staff; the rental of an office in Rome, administration and communication at headquarters and the related costs of the Asia and Africa II Divisions, which also undertake project supervision over IFAD loans. UNOPS was confident that all IFAD-related costs were fully recovered owing to the overall positive performance of the Fund and the Asia and Africa II Divisions. On the basis of schedule 2, the Board was therefore unable to determine whether the fees earned for the IFAD supervision services rendered did, in fact, cover all costs incurred.

51. **The Board recommends that UNOPS should (a) compute the full costs incurred in respect of services to IFAD to determine the feasibility of this service line; and (b) disclose the full IFAD costs in schedule 2 to the financial statements.**

8. End-of-service liabilities

52. UNOPS has not provided for after-service health insurance liabilities in its financial statements. However, the estimated liability has been disclosed in note 20 to the financial statements and amounted to $38.9 million as at 31 December 2001. UNOPS informed the Board that a consulting actuary has been engaged to propose alternatives to fund this liability. The Board also noted that UNOPS, in accordance

with its accounting policy, did not accrue for or disclose liabilities in respect of annual leave and other termination benefits. The Board is concerned that since the UNOPS operational reserve was already at a very low level, separation benefits actually incurred may not be fully funded.

53. **The Board recommends that UNOPS, in conjunction with the United Nations and other funds and programmes, review the funding mechanism and targets for end-of-service benefits. The Board considers that UNOPS may need to expedite its consideration of funding the end-of-service liabilities, given its unique funding principles.**

9. Forecasts for 2002

Budget exercise

54. As a result of the financial position of UNOPS as at 31 December 2001 and the concerns expressed by the Executive Board, there was doubt about the ability of UNOPS to continue at the present level of operations. Therefore, the Board of Auditors reviewed UNOPS plans for future actions, with a view to assessing the reasonableness of the assumptions made for the 2002 budget.

55. In January 2002, the Executive Director of UNOPS made a presentation to the Executive Board concerning the predicted result for 2001 and budgeting methods used in compiling the 2002 budget. In response to the 2001 result, the UNOPS management called for a more detailed, substantiated and conservative approach to revise the 2002 financial targets and administrative expenditure, while also identifying the obstacles that led to the 2001 shortfall. Subsequent to the presentation of the financial results to the Management Coordination Committee in March 2002, the committee raised concerns about the budget for the biennium 2002-2003 and requested the organization to compile an achievable budget for 2002. UNOPS aimed to demonstrate by mid-year whether it would be on course to meet the 2002 targets.

56. UNOPS undertook a portfolio review with a new methodology whereby, after an in-depth analysis of projects, elements were classified as “guaranteed”, “hard” or “soft”, in order to estimate the project delivery for 2002. “Guaranteed delivery” refers to projects based on approved budgets where internal and external factors affecting delivery are non-existent or minimal. “Hard delivery” refers to signed projects and pipeline projects awaiting budget approval and where there is a low probability that delivery against those funds will be affected. “Soft delivery” is based on projects at the conceptual stage or still under negotiation with a moderate to high probability that delivery of approved projects will be affected by internal or external risk factors.

57. The estimated project delivery according to the three categories was as follows: “guaranteed”, $335.2 million; “hard”, $154.8 million; and “soft”, $113.4 million. The estimated project delivery and resulting project income for 2002 was set at $503.2 million and $35.4 million respectively, taking the above categories into account. The Board noted that the total hard and guaranteed delivery only amounted to $490 million, which meant that the remainder of the projected delivery is made of “soft delivery” of $13.2 million (2.6 per cent), which would translate into project income of $0.9 million using the average forecast project income rate of 7 per cent.

58. Each division chief was required to assess his division’s delivery for 2002, and to establish the amount for which they would be held personally accountable. The

aggregate of the “divisional chiefs’ commitment” was some $509.8 million. The Board was concerned that **UNOPS opted to set a target of $503.2 million that included some $13.2 million worth of project delivery with a moderate to high risk**. The inability of UNOPS to meet this delivery forecast could result in a loss of support cost income in the range of $378,000 to $924,000 at the expected earnings rate of 7 per cent.

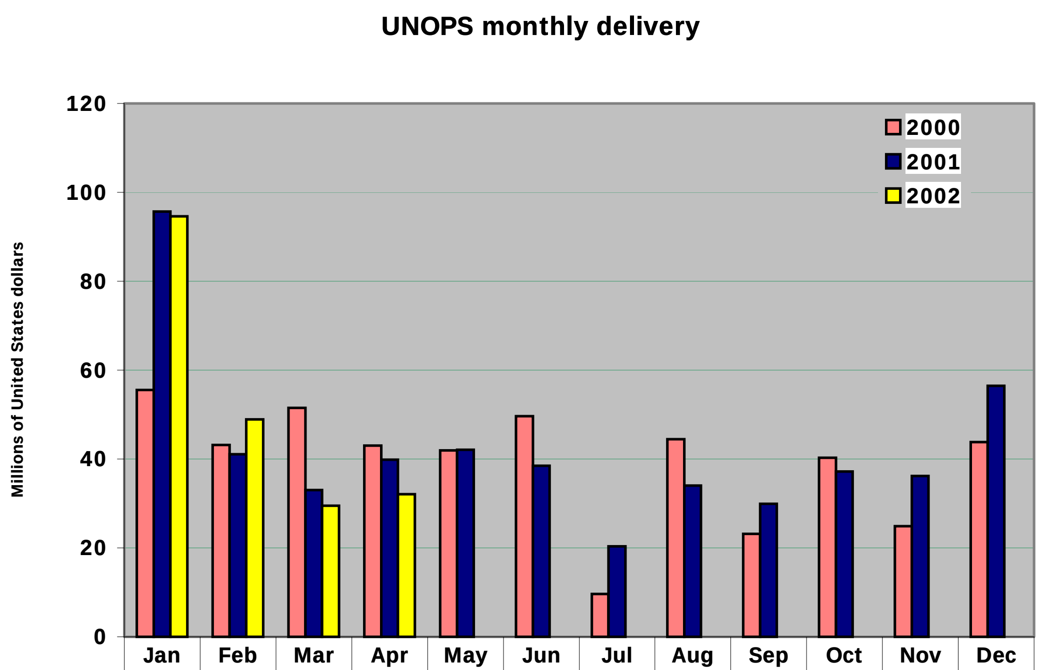
59. **The Board recommends that UNOPS consider presenting to the Executive Board for approval variable budgets based on several levels of activity, clearly identifying the most likely level of activity.**

Income strategy

60. The Board reviewed the various analyses performed by UNOPS to monitor the delivery of each division. One such analysis is presented in graph 4 below, which compares the actual 2000, 2001 and 2002 project delivery as at 30 April 2002.

61. Cumulative delivery, as a percentage of total delivery, as at April was on average 41 per cent for 2000 and 41.6 per cent for 2001. As at April 2002, the actual cumulative delivery results amounted to 40.8 per cent of the forecast 2002 total delivery. The estimated delivery of $503.2 million for 2002 is relatively consistent with the actual delivery of $504.7 million for 2001. In addition, the cumulative delivery of $205 million as at 30 April 2002 is relatively consistent with 2001 delivery of $210 million at that time. However, the Board noted that the 2002 budget provided that project income should be based on an average of 7 per cent of delivery, while for 2000 and 2001, the percentages were 7.8 and 7.5, respectively. This resulted in project income for 2002 estimated at $35.2 million, compared to $37.8 million in 2001, although the project delivery is relatively the same. While UNOPS had been purposefully conservative in setting the rate of project income in anticipation of achieving a higher return, the Board noted that actual rate of project income as at the end of April 2002 was indeed 7 per cent only. UNOPS informed the Board that, for May 2002, project delivery amounted to $49 million.

Graph 4
United Nations Office for Project Services delivery per month



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2000	56	43	51	43	42	50	10	44	23	40	25	44
2001	96	41	33	40	42	39	20	34	30	37	36	57
2002	95	49	29	32								

62. **The Board recommends that UNOPS continue to monitor closely the rate of project income and to re-evaluate any assumptions as well as overall project income strategy and policy.**

Administrative expenditure strategy

63. Various administrative budget proposals were prepared for 2002. The first budget requests from individual division chiefs to senior management amounted to $52.7 million. This amount was reduced by a UNOPS Executive Group to $47 million, as reflected in the budget submitted to the Management Coordination Committee on 7 April 2002. The Committee took a decision at that meeting that the administration expenditure for 2002 should be capped at $43 million and that that ceiling should not be exceeded without its approval. The amount capped is in line with the initial UNOPS income projections for 2002.

64. The Management Coordination Committee working group then conducted a detailed review of the budgetary and staffing level issues involved, in order to identify the base administrative budget level for 2002. Subsequently, a further revised budget was drawn up by UNOPS reflecting total administration expenditure of $45.3 million. The working group had made suggestions to reduce expenses by a further $1.3 million. On 30 May 2002, the budget was discussed with the Committee, which agreed to a revised cap of $44 million. UNOPS informed the

Board that a budget to meet the cap of $44 million had been prepared and submitted to the Committee for review. The summary of the actual administrative expenditure costs for 2000 and 2001, as well the various budgeted administrative costs and the cumulative administrative expenditure as at April 2002, are presented in annexes IV and VI.

65. The Board noted that, while the 2002 budget had not yet been finalized, UNOPS had already spent 35 per cent of the $44 million budget cap as at 30 April 2002 without taking into account the possible effects of the savings of staff costs. Most of the amounts payable to the United Nations for central services had been obligated at the beginning of the year. However, no amount had yet been paid or obligated to UNDP for central services and internal audit services, which amounted to $2.3 million as per the 2002 budget, as well as tax, which in prior years amounted to $2 million.

66. The Board noted that, while the actual staff-related costs in April were in line with the percentage of total costs of previous years, it still made up the largest portion of expenditure (65 per cent). The number of personnel paid against the UNOPS administrative budget as at December 2001 was 427. During the budgetary process, and following a functional review, a number of posts were identified as being unnecessary. The total number of Professional and General Service staff to be affected by the staff cuts initially amounted to 21 and 33, respectively. In addition, two junior professional officers and 10 persons working as independent contractors under special service agreements were affected by the cuts, which therefore affected 66 positions in total. UNOPS expected the cuts to result in separation costs of $2.2 million, but had not determined the resulting savings. **Separation costs would effectively reduce the present operational reserve of $5 million to $2.8 million.** UNOPS identified further reductions in the operational division from the reduction of short-term contracts, although this exercise had been conducted after the Board's review.

67. **The Board recommends that a clear and definite action plan be compiled on how, where and when savings from staff cuts will be made and monitored, and that all costs should be closely monitored and a revised submission made to the Management Coordination Committee in order to obtain approval, should it become evident that the required cap of administrative expenditure will be exceeded.**

68. In terms of the lease agreement, UNOPS is responsible for the total cost, but the landlord may take into consideration the potential timely notice in order to secure other tenants. UNOPS has decided to redeploy staff, as far as possible and intends to relocate some staff currently in New York. The rest of the staff will be consolidated within the Chrysler building and the remaining space will be sublet. The Board confirmed that subleasing is an option according to the lease agreement.

69. The Board noted that UNOPS had commenced informal dialogue with other United Nations organizations to lease a part of the expected vacant space at the Chrysler building. One contract had been signed for nine months of 2002, resulting in income of $45,000 (three units). Three other organizations have expressed an interest in letting a total of 68 units. Had the contracts been signed by 1 July 2002, the expected rental income of $0.54 million would have been earned over the remaining six months of the year. This would mean that UNOPS would still have to cover $3.26 million of the annual rental costs of the Chrysler building. Since there were no firm commitments in place, there is still some doubt that savings will in fact be achieved in 2002 in this regard.

70. UNDP is in the process of implementing a new enterprise resource planning system. The current working arrangement between UNOPS and UNDP, set out in Executive Board decision 94/12 of 9 June 1994, is that UNOPS administrative support, including that relating to financial and personnel matters, will continue to be provided by UNDP.

71. Currently, both UNDP and UNOPS use IMIS as the principal accounting system. Owing to numerous functions that are being performed by UNDP for UNOPS (such as investment management, bank management and internal audit), the Board is of the opinion that UNOPS would have to consider whether UNOPS will have to implement changes to its current system in order to continue in the current relationship with UNDP; implement a new system or modify IMIS in such a way that UNOPS can manage the system independently; create a bridge between the UNOPS system and the future enterprise resource planning system of UNDP and/or perform a feasibility study for the United Nations Secretariat to possibly undertake tasks currently performed by UNDP.

72. While UNOPS information technology personnel were involved with UNDP in the selection process of the new enterprise resource planning system, no reference to the impact of future change or modification of system for UNOPS had been made in the 2002 budget. Since UNDP plans to implement the enterprise resource planning system in 2004, UNOPS does not have much time to properly plan and implement its own information and communication technology strategy. Related costs could be significant and, although the amount relating thereto is still uncertain, UNOPS has only included in the budget the cost of time spent by the staff involved in the UNDP enterprise resource planning process. The costs relating to information and communication technology may have an impact on the operational reserve to the extent not covered by income. UNOPS informed the Board that UNDP has not informed it of costs associated with the enterprise resource planning.

73. **The Board recommends that UNOPS intensify its efforts to attain and make provision for all possible and foreseeable expenditure in respect of information and communications technology both in the 2002 budget and beyond. The specific effects of a new computer system on accurate financial reporting should be considered rather urgently.**

Conclusion on 2002 budget forecasts

74. The Board notes with concern that, for the 2002 budget (version as at 31 May 2002), the last UNOPS budget proposal of $45.3 million exceeded the forecast income of $43 million by $2.3 million. UNOPS has subsequently estimated its income at $44.3 million by reassessing expected income from other services. UNOPS intends to cover expenses estimated at $2.2 million, relating to staff separation, from the operating reserve. **The Board is concerned that UNOPS may not cover all its administrative expenditure of $45.3 million (capped at $44 million) with the projected level of income**, bearing in mind the volatility of project income and the problems experienced with the project management officer workload system. Furthermore, costs related to the enterprise resource planning system may not be provided for in 2002 although later incurred out of necessity. **In addition, separation costs have not been finalized and would impact directly on operational reserves since these costs have not been provided for elsewhere.**

75. In note 15 to the financial statements for the biennium 2000-2001, UNOPS disclosed the risks that could impact on the curtailment of future operations and the measures taken by management to address them.

76. UNOPS did not have a contingency plan on measures to be taken in the event that the 2002 operations result in a deficit which cannot be absorbed by the remaining balance of the operational reserve.

77. **The Board recommends that UNOPS prepare a contingency plan to be submitted to the Executive Board for approval, to address measures to be taken in the event that the operational reserve is unable to absorb possible deficits.**

10. Junior professional officers

78. The Board noted that UNOPS has the benefit of some 30 junior professional officers that render services at little cost to the organization, since these staff are remunerated by the donor countries. Most of these officers are assigned at the P-2 level and it would therefore cost approximately $100,000 per person per annum to replace them with permanent staff.

79. **The Board recommends that UNOPS consider expanding the use of junior professional officers as a cost-effective mechanism, especially in these times of financial constraints.**

11. Reform plan

80. In November 2000, UNOPS recognized the need to redesign its operations and management. The development of the "reform plan" was undertaken in 2001 and the blueprint was completed by February 2002. UNOPS decided to defer the implementation of the reform plan until the outcome of an internal review by the Secretary-General was made known. In his note dated 25 January 2002,[3] the Secretary-General outlined key recommendations for operational improvements and expressed his satisfaction that UNOPS had initiated measures to implement them.

81. The reform plan focuses on the restructuring of UNOPS around its clients and not necessarily around geographical locations. UNOPS management is of the opinion that UNOPS would be in a situation to render better service to its clients with improved communication lines between UNOPS and other United Nations organizations. Nevertheless, the fee structure and the cost structure have not yet been addressed in the reform plan. The Management Coordination Committee suspended the implementation of the reform plan until the 2002 budget is approved in June 2002. The Board is of the opinion that the reform plan should be reviewed by the Committee in conjunction with the budget for 2002 so that all short-term and medium-term assumptions are appropriately addressed in context of the sustainability on UNOPS and to ensure that the recommendations made by the Secretary-General were implemented.

12. Write-off of losses of cash, receivables and property

82. UNOPS wrote off an amount of $202,000 in respect of costs incurred in excess of project budgets as a result of the appointment of a person on a two-year contract for a specific project. The parties to the project were not able to absorb the excess costs. The division of UNOPS involved was of the view that lack of information from implementing IMIS and the office move resulted in the error being detected at a late stage. UNOPS is putting in place a mechanism to ensure that staff are aware of total cost of project personnel.

13. Ex gratia payments

83. UNOPS informed the Board that there were no ex gratia payments during the biennium 2000-2001.

D. Management issues

1. Service level agreements

84. UNOPS reimburses UNDP for the cost of, inter alia, UNDP central support services, which include finance, administration, personnel and internal audit. The memorandum of understanding between UNDP and UNOPS indicates that the "relevant delineation of the respective functions and responsibilities between UNOPS and UNDP and their corresponding costs shall be covered in separate subsidiary agreements".

85. The Board noted that there were draft service level agreements between UNOPS and UNDP. However, the Board was concerned that, with the exception of internal audit services, the respective functions and responsibilities between UNOPS and UNDP were not finalized and the draft agreements did not cover human resources.

86. The Executive Board urged UNDP and UNOPS to develop a more transparent chargeback structure. This situation underlines the need for a properly communicated service level agreement that is open and transparent and which assigns responsibility and accountability.

87. **The Board recommends that the agreements between UNOPS and UNDP be finalized expeditiously, in order to regulate the functions of central services received from UNDP and should include the respective functions, responsibilities and cost structures between UNOPS and UNDP. Furthermore, the Board recommends that a service level agreement be concluded for human resources.**

2. Internal oversight reports

88. The Office of Audit and Performance Review of UNDP perform the internal oversight function for UNOPS. During the biennium ended 31 December 2001, the Office completed a number of internal audits and investigations at UNOPS, which are summarized as follows:

Table 3
Summary of internal audit investigations at UNOPS

Internal audit and oversight services provided	*Reports issued*		
	2000	*2001*	*Total*
Internal audits/reviews of functions	5	1	6
Internal audits/reviews of projects	23	15	38
Internal audits/reviews of organizational units	5	4	9
Total UNOPS audits/reviews	**33**	**20**	**53**

89. The majority of the reports focused on projects. As in the previous biennium, the Office of Audit and Performance Review did not perform any audits evaluating and reporting on the reliability of the accounting and other data developed by UNOPS for the production of financial statements.

90. **The Board recommends that UNOPS arrange for internal oversight coverage on financial procedures, controls and data.**

3. Information and communications technology

91. General controls establish a framework of overall control over the information and communications technology environment and provide reasonable assurance that it supports the overall objectives of internal control which are important as they serve as the foundation for controls of all application systems and ensure the effective operation of procedures, including the controls over the design, implementation, security, use and amendment of programmes and files. The findings of these reviews highlighted that, although some general controls were in place, several weaknesses existed in the control environment as a whole. The most significant control weaknesses at UNOPS were:

(a) There was no formally documented, approved and updated information technology strategic plan, disaster recovery plan, or back-up and restore procedures;

(b) Activity logs and access violation logs were not generated and consequently, not reviewed by UNOPS for the UNIX servers;

(c) System administrators at UNOPS shared the same system administrator identification, which could lead to a lack of accountability;

(d) Weaknesses were identified in protection against virus infiltration and illegal software.

92. **The Board recommends that UNOPS (a) compile a short-term and long-term strategic plan for the deployment of information and communications technology, which should be updated on a continuous basis; and (b) develop formally documented and approved procedures or guidelines on aspects such as security, disaster recovery planning, back-ups and system development.**

4. Cases of fraud and presumptive fraud

93. UNOPS informed the Board that there were no cases of fraud and presumptive fraud.

E. Acknowledgement

94. The Board of Auditors wished to express its appreciation for the cooperation and assistance extended to its staff by the Executive Director and staff of the United Nations Office for Project Services.

(*Signed*) Shauket A. **Fakie**
Auditor-General of the Republic of South Africa

(*Signed*) Guillermo N. **Carague**
Chairman, Philippine Commission on Audit

(*Signed*) François **Logerot**
First President of the Court of Accounts of France

25 June 2002

Annex I

Follow-up action taken by the United Nations Office for Project Services to implement the recommendations of the Board of Auditors in its report for the biennium ended 31 December 1999[a]

The Board has followed up on the actions taken by the United Nations Office for Project Services to implement the Board's recommendations made in the context of its report for the biennium ended 31 December 1999. Table A.1 summarizes the status of implementation of all the previous recommendations, while table A.2 details specifically those recommendations not implemented and those recommendations under implementation which require further comment.

In its previous report, the Board had made 13 recommendations. A total of ten (77 per cent) of these recommendations were implemented, and three (23 per cent) were under implementation.

Table A.1
Summary of status of implementation of recommendations for the biennium 1998-1999

Topic	*Implemented*	*Under implementation*	*Not implemented*	*Total*
A. Financial issues				
1. Expendable and non-expendable equipment	para. 10 (a)			1
2. Unliquidated obligations	para. 10 (b)			1
3. Bank and cash management		para. 33		1
Subtotal				
Number	**2**	**1**	**-**	**3**
Percentage	**67**	**33**		
B. Management issues				
1. Business planning	para. 40			3
	para. 10 (c)			
	para. 45			
2. Project management	para. 10 (d)	para. 62		6
	para. 10 (e)	para. 65		
	para. 56			
	para. 57			
3. Relocation	para. 85			1
Subtotal				
Number	**8**	**2**	**-**	**10**
Percentage	**80**	**20**		
Grand total				
Number	**10**	**3**	**-**	**13**
Percentage	**77**	**23**		

[a] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 5J* (A/55/5/Add.10), para. 10.

Table A.2
Details on previous recommendations for the biennium 1998-1999 not implemented or under implementation

	Management		
		As at 30 April 2002	
Component/area of concern	*Recommendation 1998-1999*	*Specific management action/comments*	*Comments of the Board*
Imprest accounts, para. 33	The Board recommends that UNOPS review, on a monthly basis, the returns from imprest account holders and take immediate action to hasten any missing returns. The Board also recommends that UNOPS promptly reconcile all the returns from imprest account holders, so as to ensure that it effectively monitors expenditure disbursed in the field.	The imprest accounts will be reconciled on a monthly basis.	Under implementation. The Board identified instances where incorrect balances had been reflected in the overall imprest reconciliation. While not material enough for this report, the differences were reported to UNOPS in a management letter. The Board will keep this under review.
Project management, para. 62	The Board recommends that UNOPS endeavour to strengthen the range of performance indicators included in project documents, so as to allow progress against objectives and subobjectives to be quantified and reviewed as fully as possible.	Substantive review of progress of project is currently conducted through regular reporting, monitoring missions and the project performance evaluation reports and tripartite reviews process. UNOPS believes that the strengthening of this review process is the appropriate way to develop the monitoring of project progress.	Under implementation. The Board noted improvements and will continue to keep this matter under review.

	Management		
		As at 30 April 2002	
Component/area of concern	*Recommendation 1998-1999*	*Specific management action/comments*	*Comments of the Board*
Project management, para. 65	The Board recommends that UNOPS work with funding organizations to undertake periodic project performance evaluation reports and tripartite reviews for all projects.	Substantive review of progress of project is currently conducted through regular reporting, monitoring missions and the project performance evaluation reports and tripartite reviews process. UNOPS believes that the strengthening of this review process is the appropriate way to develop the monitoring of project progress.	Under implementation. The Board noted improvements and will continue to keep this matter under review.

Annex II

Actual income and expenditure compared to the budget for the period from 1997 to 2001

Actual income and expenditure compared to the budget for the period from 1997 to 2001
(In millions of United States dollars)

	Budget/ forecast 1997	*Actual 1997*	*Difference (actual from forecast/ budget)*	*Budget/ forecast 1998*	*Actual 1998*	*Difference (actual from forecast/ budget*	*Budget/ forecast 1999*	*Actual 1999*	*Difference (actual from forecast/ budget)*	*Budget/ forecast 2000*	*Actual 2000*	*Difference (actual from forecast/ budget)*	*Budget/ forecast 2001*	*Actual 2001*	*Difference (actual from forecast/ budget)*
Project delivery	500.0	463.1	(36.9)	550.0	537.8	(12.2)	550.0	559.9	9.9	590.0	471.1	(118.9)	616.0	504.7	(111.3)
Income															
Income from project portfolio	35.3	35.0	(0.3)	38.2	43.5	5.3	42.9	43.0	0.1	42.7	36.8	(5.9)	47.4	37.9	(9.5)
Income from services only	4.0	3.7	(0.3)	5.1	4.1	(1.0)	5.6	5.8	0.2	6.1	6.5	0.4	8.0	7.0	(1.0)
Other income	1.3	1.8	0.5	1.2	2.5	1.3	2.6	3.1	0.5	2.8	5.2	2.4	1.4	2.3	0.9
Total income	**40.6**	**40.5**	**(0.1)**	**44.5**	**50.1**	**5.6**	**51.1**	**51.9**	**0.8**	**51.6**	**48.5**	**(3.1)**	**56.8**	**47.2**	**(9.6)**
Total recurring Administrative expenditure	38.5	36.7	1.8	43.6	42.0	1.6	48.1	47.4	0.7	51.6	52.3	(0.7)	55.3	52.8	2.5
Net surplus/(deficit)	2.1	3.8	1.7	0.9	8.1	7.2	3.0	4.5	1.5	-	(3.8)	(3.8)	1.5	(5.6)	(7.1)

Annex III

Analysis of project income

(In thousands of United States dollars)

Income	*Project delivery 2000-2001*	*Project income 2000-2001*	*Project income 1998-1999*	*Increase/ (decrease) from 1998-1999*	*Percentage*
UNDP	292 712	26 693	40 014	(13 321)	(33)
Implementing agency (UNDP)	55 043	4 926	6 807	(1 881)	(28)
Trust fund projects (UNDP)	193 130	14 773	15 792	(1 019)	(6)
Management service agreements (UNDP)	242 829	15 150	16 825	(1 675)	(10)
UNDCP	24 744	1 793	2 396	(603)	(25)
Other United Nations organizations	167 288	11 285	4 630	6 655	(144)
Subtotal, Project income	**975 746**	**74 619**	**86 464**	**(11 845)**	**(14)**
IFAD		12 211	9 926	2 285	23
Advisory service		1 167	0	1 167	100
Interest income		1 914	3 019	(1 105)	(37)
Miscellaneous income		2 256	1 341	915	68
Programme of Assistance to the Palestinian People		275	200	75	38
Total	**975 746**	**92 443**	**100 950**	**(8 507)**	**(8)**

Annex IV

Analysis of administrative expenditure

Object of expenditure	*Actual 2000 administrative expenditure*	*Actual 2001 administrative expenditure*	*Original 2002 budget*	*Initial 2002 revised budget*	*End of May revised 2002 budget*	*Actual April 2002*	*Percentage of second revised budget*
Staff-related costs							
Salaries	15 853	16 790	19 875	16 440	15 953	5 388	33.8
Common staff costs	8 089	9 058	8 063	8 522	8 373	2 076	24.8
Temporary assistance	2 751	1 839	1 381	1 355	1 105	580	52.5
Activities of limited duration	3 309	3 779	4 007	3 240	3 240	1 004	31.0
Overtime	193	94	102	41	41	34	82.9
Consultants	2 245	2 672	2 149	2 020	1 701	1 078	63.4
Subtotal	**16 587**	**34 232**	**35 577**	**31 618**	**30 413**	**10 160**	**33.4**
Rental, maintenance and non-expendable equipment							
Rental and maintenance of premises	4 601	4 747	4 702	4 659	4 650	1 625	34.9
Rental and maintenance of equipment	180	157	179	179	180	74	41.1
Furniture and equipment	356	123	71	44	44	27	61.4
Subtotal	**5 137**	**5 027**	**4 952**	**4 882**	**4 874**	**1 726**	**35.4**
Information technology							
Mainframe hardware	-	41		1	1	-	0.0
Maintenance of PC hardware	-	23	323	233	233	90	38.6
Computer systems equipment	194	605	958	373	273	80	29.3
System development contracts	105	-		-	-		
Subtotal	**299**	**669**	**1 281**	**607**	**507**	**170**	**33.5**
Other Administrative expenditure							
Training	593	195	141	26	26	43	165.4
Staff travel	2 760	2 060	2 085	1 275	1 027	467	45.5
Contracts	849	1 363	1 227	639	584	452	77.4
Printing and publications	109	73	64	10	10	8	80.0
Communications	1 132	1 139	1 418	1 145	956	592	61.9
Miscellaneous services	837	714	554	505	505	129	25.5
Office supplies	517	358	279	201	201	131	65.2
Hospitality	19	22	18	4	4	2	50.0
Subtotal	**6 816**	**5 924**	**5 786**	**3 805**	**3 313**	**1 824**	**55.1**

Object of expenditure	*Actual 2000 administrative expenditure*	*Actual 2001 administrative expenditure*	*Original 2002 budget*	*Initial 2002 revised budget*	*End of May revised 2002 budget*	*Actual April 2002*	*Percentage of second revised budget*
United Nations and UNDP-related costs							
– UNDP country office service costs	3 004	2 702	2 633	2 633	2 633	561	21.3
– Services provided by UNDP/Office of Audit and Performance Review	1 020	821	900	793	793		0.0
– UNDP central support services	2 356	1 738	1 662	1 528	1 528		0.0
– United Nations central services	1 180	1 664	1 206	1 206	1 206	1 082	89.7
Subtotal	**7 560**	**6 925**	**6 401**	**6 160**	**6 160**	**1 643**	**26.7**
Total recurrent administrative expenditure	**36 399**	**52 777**	**53 997**	**47 072**	**45 267**	**15 523**	**34.3**
Non-recurrent administrative expenditure							
Information system project	3 006	-	-	-			
Subtotal	**3 006**	**-**	**-**	**-**	**-**		
Grand total	**39 405**	**52 777**	**53 997**	**47 072**	**45 267**	**15 523**	**34.3**

Total expenditure for the biennium 2000-2001 amounted to $108 million.

Annex V

Table prepared by the United Nations Office for Project Services for the monitoring of the prior period financial parameters

	UNOPS financial parameters								*Total operational reserve*			
Year	*Administrative expenditure*[a]	*Delivery*	*Average income rate (project portfolio) (Percentage)*	*Portfolio income*	*Service income*	*Other income*	*Total income*	*Surplus (recurrent)*	*Non-recurrent expenditure*	*1 January opening balance*	*31 December closing balance*	*Required*[b]
1996	33.6	430.8	7.3	31.6	3.2	3.4	38.2	4.6		13.0	17.6	6.8
1997	36.7	463.1	7.6	35.0	3.7	1.8	40.5	3.8		17.6	21.4	18.6
1998	42.0	537.8	8.1	43.5	4.1	2.5	50.1	8.1	1.5	21.4	29.5	20.0
1999	47.4	559.9	7.7	43.0	5.8	3.1	51.9	4.5	16.7	29.5	17.4	23.2
2000	52.3	471.1	7.8	36.8	6.5	5.2	48.5	-3.8	3.0	17.4	10.6	25.0
2001	52.8	504.7	7.5	37.9	7.0	2.3	47.2	-5.6		10.6	5.0	23.1
Total	**264.8**	**2 967.4**	**7.7**	**227.8**	**30.3**	**18.3**	**276.4**	**11.6**	**21.2**	**109.5**	**101.5**	**116.7**
Average	**44.1**	**494.6**	**7.7**	**38.0**	**5.1**	**3.1**	**46.1**	**1.9**	**3.5**	**18.3**	**16.9**	**19.5**

[a] 1995-1998: services income prior to changing fees and travel income.
[b] 1995: UNOPS payments to UNDP country offices were treated as a reduction of portfolio income, not as an administrative expenditure.

Annex VI

Analysis of expenditure subtotals as a percentage of total

Object of expenditure	*Actual 2000 administrative expenditure*	*Actual 2001 administrative expenditure*	*Original 2002 budget*	*Initial 2002 revised budget*	*End of May revised 2002 budget*	*Actual April 2002*
	(Percentage)					
Staff-related costs	68.5	69.1	70.0	69.9	69.5	65.4
Rental, maintenance and non-expendable equipment	9.8	9.5	9.2	10.4	10.8	11.1
Information technology	0.6	1.3	2.4	1.3	1.1	1.1
Other Administrative expenditure	6.6	7.0	6.6	5.3	5.0	11.8
UNDP-related costs	14.5	13.1	11.9	13.1	13.6	10.6

Chapter III
Audit opinion

We have audited the accompanying financial statements, comprising statements I to III, schedules 1 and 2 and the supporting notes of the United Nations Office for Project Services for the biennium ended 31 December 2001. The financial statements are the responsibility of the Executive Director. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the common auditing standards of the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, and as considered by the auditor to be necessary in the circumstances, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Executive Director, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the audit opinion.

In our opinion, these financial statements present fairly, in all material respects, the financial position as at 31 December 2001 and the results of its operations and cash flows for the period then ended in accordance with the stated accounting policies of the Office set out in note 2 to the financial statements, which were applied on a basis consistent with that of the preceding financial period.

Without qualifying our opinion above, we draw attention to the financial position of the Office as disclosed in note 15 to the financial statement. Given the Office's financial position as at 31 December 2001 and the possible failure to meet its 2002 targets, UNOPS may not be able to fund in full any deficit from the operational reserve. This situation may result in the Office having to curtail the scale of its operations.

The operational reserve is not at the level required by the Executive Board of the Office as at 31 December 2001. Except for the level of the operational reserve, in our opinion, the transactions of the Office, which we have tested as part of our audit have, in all significant respects, been in accordance with the Financial Regulations and legislative authority.

In accordance with article XII of the Financial Regulations, we have also issued a long-form report on our audit of the financial statements of the Office.

(*Signed*) Shauket A. **Fakie**
Auditor-General of the Republic of South Africa

(*Signed*) Guillermo N. **Carague**
Chairman, Philippine Commission on Audit

(*Signed*) François **Logerot**
First President of the Court of Accounts of France

25 June 2002

Chapter IV

Financial statements for the biennium ended 31 December 2001

Notes to the financial statements

Note 1
Objective of the United Nations Office for Project Services

(a) The objective of UNOPS is to provide high-quality, timely and cost-effective development services for the successful implementation of projects undertaken by United Nations Member States.

(b) UNOPS offers the international cooperation community a broad range of services which include:

(i) Comprehensive project management, including contracting for technical expertise and backstopping;

(ii) Implementation of components of projects under execution by other organizations of the United Nations system or by national institutions;

(iii) Project supervision and loan administration on behalf of international financial institutions;

(iv) Management services for multilateral, bilateral and beneficiary-financed projects.

(c) UNOPS serves its clients while upholding the impartiality and fairness embodied in the Charter of the United Nations.

Note 2
Summary of significant accounting policies

(a) The financial statements of UNOPS, in all material aspects, are prepared in accordance with the United Nations system accounting standards.

(b) As required by its financial regulations, UNOPS maintains the following accounts:

(i) The UNOPS account, to which UNOPS credits all of the income derived from its services and against which all operational costs of UNOPS are charged;

(ii) Separate special accounts, as required by UNOPS activities, for the identification, administration and management of resources entrusted to the charge of UNOPS by a funding source. These accounts are referred hereinafter as special accounts.

(c) The financial statements reflect the application of the following significant accounting policies:

(i) Financial policies applicable to the UNOPS account

a. Income. All income is accounted for on an accrual basis.

b. Expenditure. All expenditure is accounted for on an accrual basis, except for that relating to staff entitlements, which are accounted for on the basis of cash disbursements only. Expenditures chargeable to the UNOPS account are related to the UNOPS administrative budget, as approved by the Executive Board, and are incurred provided sufficient amounts are available in the UNOPS income account so that the self-financing principle is maintained.

(ii) Financial policies applicable to the special accounts

a. Project expenditure is accounted for on an accrual basis and is incurred following authorization of the funding source in the form of project budgets. The expenditure, plus the support costs and fees charged by UNOPS, is reported to the funding sources so that they can incorporate such expenditure in their records and financial statements. Project expenditures include unliquidated obligations raised according to the following criteria:

i. Experts and other project personnel. Costs relating to the period of contractual service falling within the current year;

ii. Travel on official business. Costs of travel taking place in the current period and travel which commences before the end of the current year but extends into the following year;

iii. Subcontracts. Payments falling due in the current year according to the terms of the contract or payment schedule;

iv. Fellowships. Cost of the fellowship from the anticipated date of commencement of study or start of the current year to completion of study or end of the current year, whichever is earlier;

v. Group training. Full cost of any training activity held in the current year or beginning in the current year and ending in the next year;

vi. Equipment. Full cost of contractual agreement or firm order placed with the supplier prior to the end of the current year up the amount provided in the current year's budget;

vii. Miscellaneous. Cost of events (e.g., hospitality and reports) and other ad hoc items.

b. Certain flexibility provisions may be applied to expenditure incurred under projects funded by the United Nations Development Programme (UNDP). In any given year, expenditure may exceed an approved project budget for that year by $20,000 or 4 per cent of the year's budget, whichever is greater, provided overall overexpenditure incurred on the programme for that year does not exceed 2 per cent of the total allocated by UNDP to UNOPS for the year.

(iii) Financial policies applicable to all accounts

a. Exchange rates:

i. For the purposes of accounting for assets, liabilities and the maintenance of other financial records, other currencies are translated into United States dollars at the United Nations operational rate of exchange in effect on the date of the report or transaction;

ii. For the Japanese procurement programme, expenditure incurred in other currencies is fixed at the United Nations operational rate of exchange in effect at the date of the establishment of the related obligation. This procedure was agreed upon with the UNDP Treasury Division, based on the ability of UNDP to enter into hedging arrangements in order to protect against significant fluctuations in exchange rates that might occur between the date of obligation and the date of payment. Any difference between the amount recorded when the purchase order was issued and the payment of such obligation is transferred to UNDP as gains or losses on exchange. These gains or losses are effectively offset by opposite gains or losses booked as a result of having held the currency in UNDP accounts over the period. For the biennium ended 31 December 2001, the total of such differences amounted to the equivalent of $1,303,788.

b. Capital expenditure:

i. The full cost of non-expendable equipment is charged to the project accounts or the UNOPS administrative budget as appropriate in the year in which it is purchased. Items considered non-expendable equipment are purchases of equipment valued at $500 or more per unit with a serviceable life of at least five years, and items of equipment included in any special list for which formal inventory records are maintained;

ii. The inventory held at UNOPS Headquarters and Decentralized Offices as at 31 December 2000 based on acquisition costs was $6,085,633 and $1,821,694 respectively. For the biennium ended 31 December 2001, the inventory at UNOPS Headquarters amounted to $6,556,288 and $2,758,613 for UNOPS Decentralized Offices. These capitalized inventories are not amortized nor depreciated.

Note 3
Support costs and management service agreement fees

Most of the income that UNOPS earns derives from project implementation services. Depending on the funding source of the project, UNOPS services are compensated with either support costs or management fees.

(i) Support costs:

a. Statement I shows that, for the biennium ended 31 December 2001, UNOPS earned a total of $31,618,143 for implementing UNDP-funded projects ($26,692,641 as executing agency and $4,925,502 as implementing agency).

b. Statement I also shows that, for the biennium ended 31 December 2001, UNOPS earned $1,793,069 and $14,772,974 for implementing projects funded by the United Nations International Drug Control Programme and UNDP-administered trust funds, respectively.

c. The item entitled “Projects on behalf of other United Nations organizations” in the amount of $11,284,772 represents support costs earnings from clients of the United Nations system, including the Department of Peacekeeping Operations, the Office of the Iraq Programme, the Office of the United Nations High Commissioner for Human Rights, the Joint United Nations Programme on HIV/AIDS (UNAIDS), the Office of the United Nations High Commissioner for Refugees, the United Nations Verification Mission in Guatemala and others.

(ii) Management fees: UNOPS earns management fees for implementing projects under management service agreements, which are agreed upon with its clients and which vary according to the complexity of the services provided.

Statement I shows that, for the biennium ended 31 December 2001, $15,149,610 was earned from this category.

Note 4
Loan administration and project supervision

UNOPS earns fees from services it provides to the International Fund for Agricultural Development (IFAD) for loan administration and project supervision. Statement I shows that, for the biennium ended 31 December 2001, UNOPS had a gross income of $12,211,189.

Note 5
Advisory services projects

UNOPS began implementing advisory services projects wherein it earns service fees. During the biennium ended 31 December 2001, advisory services were provided to the International Atomic Energy Agency (IAEA), the Asian Development Bank, the Intergovernmental Authority on Development, the Common Fund for Commodities and UNDP. Statement I shows that, for the biennium ended 31 December 2001, UNOPS earned $1,166,839.

Note 6
Miscellaneous income

For the biennium ended 31 December 2001, the amount of $2,257,960, shown in statement I, represents the following:

Rebate of commission from UNOPS travel	137 224
Rental income	395 929
Reimbursement of services	517 938
Resources provided by the Governments of Austria, Denmark and Switzerland to defray costs of establishing offices	1 089 339
Other income	117 530
Total	**$2 257 960**

Note 7
Income from accounting services to the Programme of Assistance to the Palestinian People

UNOPS provides accounting and financial reporting services to the Programme of Assistance to the Palestinian People. Statement I shows that UNOPS earned $275,000 for providing these services for the biennium ended 31 December 2001. Project expenditure and income, reported by UNOPS to the Programme for the biennium ended 31 December 2001 amounted to $68,353,588 and $4,541,556, respectively.

Note 8
Cash

The amount of $3,277,767 reported in statement II represents balances of project imprest accounts advance by UNDP and cash received for various UNOPS contractual arrangement with other United Nations agencies and maintained by UNOPS at project sites and with the UNDP Treasury Division. Except for a petty cash of $1,000, UNOPS does not handle any other cash directly. Funds received from all sources for UNOPS-executed projects are paid to UNDP and UNOPS makes disbursements through the UNDP Treasury Division or UNDP country offices. The breakdown of the above-mentioned amount consists of:

Convertible (United States dollars)	114 528
Convertible (non-United States dollars)	3 160 415
Non-convertible (currency)	2 824
Total (United States dollars)	**3 277 767**

Note 9
Investments

The total UNOPS investments of $10,596,233 as of 31 December 2001 as reported in statement II has been invested in time deposit.

Note 10
Due from the United Nations International Drug Control Programme

UNOPS implements projects funded by the United Nations International Drug Control Programme (UNDCP) and charges support costs at a rate of 7.5 per cent of the reported delivered expenditures. All funding from UNDCP is received by UNDP on behalf of UNOPS. The amount of $4,976,808 reported in statement II represents the balance due from UNDCP for the year ended 31 December 2001, as summarized below:

Balance due from UNDCP at 1 January 2001	($10 196 963)
Funds received during 2001	14 687 125
Subtotal	$ 4 490 162
Less: 2001 expenditures reported to UNDCP	(9 466 970)
Balance due from UNDCP	$ 4 976 808

Note 11
Accounts receivable and deferred charges

The amount of $3,466,185 reported in statement II consists of (in United States dollars):

Inter-agency expenditure pending clearance	508 587
Charges awaiting reimbursement from UNDP and other United Nations organizations	2 716 522
Miscellaneous accounts receivable and other deferred charges	241 076
Total	**3 466 185**

Note 12
Due from the United Nations Development Programme

The amount of $26,390,129 reported in statement II represents the inter-fund balance between UNDP and UNOPS. The amount is due from UNDP mainly because, not having a separate treasury function, UNOPS relies on UNDP central services for the custody of its funds and disbursement of its payments.

Note 13
Accounts payable

The amount of $35,764,498 reported in statement II consists of the following:

Unliquidated obligations — UNDCP projects	$ 2 465 394
Unliquidated obligations — Other United Nations agencies	20 533 297
Unliquidated obligations — IFAD projects	1 008 646
Unliquidated obligations — UNOPS accounts	7 337 452
Total unliquidated obligations	31 344 789
Payable on medical insurance premium	299 096
Miscellaneous accounts payable	4 120 613
Total accounts payable	$35 764 498

Note 14
Amounts due to other United Nations organizations

UNOPS began implementing projects for other United Nations organizations in 1996. As of 31 December 2001, there are 286 projects for more than 27 agencies. The project agreements specify an advance payment and subsequent progress payments; the reported balance of $6,787,965 represents interest earned of $2,870,698 and the unencumbered fund balance of $3,917,267 available for the year ended 31 December 2001, in excess of project expenditures and support costs.

Note 15
Operational reserve

(a) The Executive Board at its second regular session in 2001 approved "... the proposal to change the level of the operational reserve of the United Nations Office for Project Services at 4 per cent of the rolling average of the combined administrative and project expenditures for the previous three years ...". The rolling average of the combined administrative and project expenditures for the three previous years amounted to $576,678,651; 4 per cent of this figure is $23,067,146. In order to meet 2001 administrative expenditures, no replenishment was made to the reserve in 2001. The balance in the operational reserve as of 31 December 2001 amounted to $5,028,954.

(b) In order to address this situation, in 2002 UNOPS has embarked on an extensive review of its operations, including projections for acquisition, delivery and income, and its proposed budget. UNOPS has revised the dimensions of its workforce and has reduced non-personnel components of the budget to minimum necessary levels to ensure its ability to meet its service delivery commitments to its clients in 2002 and future years. UNOPS notes that, notwithstanding its intent to balance administrative expenditure in 2002 with sufficient income so as to avoid any further drawdown from the operational reserve, should UNOPS fail to do so, and should the amount of its deficit exceed the level of its operational reserve, UNOPS may need to take further measures.

Note 16
Host Government contributions and expenses

(a) Upon the establishment of UNOPS Offices in Copenhagen, Geneva and Vienna, the following contributions were provided by the respective Governments, to defray UNOPS costs of relocation, office furniture and equipment, communication and computer system.

In cash (United States dollars)	*Denmark*	*Switzerland*	*Austria*	*Total*
Opening balance as at 1 Jan. 2000	447 051	182 190	-	629 241
Add: funds received	310 098	-	150 000	460 098
Less: expenditure	757 149	182 190	150 000	1 089 339
Ending balance as at 31 Dec. 2001	-	-	-	-

(b) In kind. The estimated market value for office accommodation provided by the Government of Côte d’Ivoire for the UNOPS Africa II Division for the biennium ended 31 December 2001 amounted to $73,800.

Note 17
Reimbursement to UNDP country offices and other United Nations agencies

For the year ended 31 December 2001, UNOPS reimbursed $2,690,783 for the cost of services provided on its behalf. $2,272,930 related to UNDP country offices and $417,853 to other United Nations agencies.

Note 18
Cost of central support services

Central services cost includes United Nations charges for services provided to UNOPS as well as reimbursement to UNDP for services. UNDP services provided were in the areas of finance, personnel, audit and information system. The total costs of central support services for year ended 31 December 2001 amounted to $4,249,915, for which $1,705,215 pertains to the United Nations and $2,544,700 to UNDP.

Note 19
Ex gratia payments and write-offs of cash and receivable

One write-off case in the amount of $202,100 was recorded and no ex gratia payments were made during the biennium ended 31 December 2001.

Note 20
Contingent financial liabilities

The United Nations Office for Project Services has not specifically accrued for after-service health insurance costs or liabilities for other types of end-of-service benefits which will be owed when staff members leave the organization. The disbursements incurred in the financial period when staff members separate are reported as current expenditures. An actuarial study and report on the UNOPS liability for post-retirement medical and dental benefits for staff was completed very recently. This report estimates the accrued liability for these benefits to be $38.9

million as at 31 December 2001. UNOPS is currently examining the report and considering funding options.

Note 21
United Nations Joint Staff Pension Fund

UNOPS is a member organization participating in the United Nations Joint Staff Pension Fund, established by the General Assembly to provide retirement, death, disability and related benefits. The Pension Fund is a funded-defined benefit plan. The financial obligation of the organization to the Fund consists of its mandated contribution at the rate established by the General Assembly, together with its share of any actuarial deficiency payments under article 26 of the Regulations of the Fund. Such deficiency payments are only payable if and when the General Assembly has invoked the provision of article 26, following a determination that there is a requirement for deficiency payments based on an assessment of the actuarial sufficiency of the Fund as of the value date. At the time of this report, the General Assembly has not invoked this provision.

02-46261 (E) 110902
0246261