AUDIT

OF

UNDP COUNTRY OFFICE

IN

SERBIA

Report No. 986
Date: 2 November 2012
**LIST OF ACRONYMS**

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>CPD</td>
<td>Country Programme Document</td>
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<tr>
<td>GLOC</td>
<td>Government Contributions towards Local Office Costs</td>
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<td>IPA</td>
<td>Instrument for Pre-Accession Assistance</td>
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<td>RCO</td>
<td>Resident Coordinator Office</td>
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<td>UNCT</td>
<td>United Nations Country Team</td>
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<td>UNDAF</td>
<td>United Nations Development Assistance Framework</td>
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<tr>
<td>XB</td>
<td>Extrabudgetary</td>
</tr>
</tbody>
</table>
Table of Contents

Executive Summary i
I. Introduction 1
II. About the Office 1
III. Detailed assessment 2
   1. Governance and strategic management 2
   2. United Nations system coordination 3
      2.1 Development activities 3
      2.2 Resident Coordinator Office 3
      2.3 Role of UNDP - “One UN” 3
      2.4 Harmonized Approach to Cash Transfers 4
   3. Programme activities 4
      3.1 Programme management 4
      3.2 Partnerships and resource mobilization 4
      3.3 Project management 5
   4. Operations 6
      4.1 Human resources 6
      4.2 Finance 6
      4.3 Procurement 6
      4.4 Information and communication technology 7
      4.5 Asset management and general administration 7
      4.6 Safety and Security 7
ANNEX I. Definitions of audit terms - Ratings and Priorities 8
United Nations Development Programme  
Office of Audit and Investigations  

Report on the audit of UNDP Serbia  
Executive Summary

From 4 to 15 June 2012, the Office of Audit and Investigations (OAI) of the United Nations Development Programme (UNDP) conducted an audit of UNDP Country Office in Serbia (the Office). The audit covered the activities of the Office during the period from 1 January 2011 to 30 April 2012. During the period reviewed, the Office recorded programme and management expenditures totalling $14 million. The last audit of the Office was conducted by OAI in 2007.

The audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing. These Standards require that OAI plans and performs the audit to obtain reasonable assurance on the adequacy and effectiveness of the governance, risk management, and control processes. The audit includes reviewing and analysing, on a test basis, information that provides the basis for our conclusions.

Audit rating

OAI assessed the Office as partially satisfactory, which means “Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.” Ratings per audit area and sub-areas are summarized below.

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<thead>
<tr>
<th>Audit Areas</th>
<th>Not Assessed/Not Applicable</th>
<th>Unsatisfactory</th>
<th>Partially Satisfactory</th>
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</thead>
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<td>2.1 Development activities</td>
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<td>2.2 Resident Coordinator Office</td>
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<td>2.3 Role of UNDP – “One UN”</td>
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<td>2.4 Harmonized Approach to Cash Transfers</td>
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<td>3. Programme activities</td>
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<tr>
<td>3.2 Partnerships and resource mobilization</td>
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<tr>
<td>3.3 Project management</td>
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<td>4.1 Human resources</td>
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<td>4.4 Information and communication technology</td>
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<td>4.5 Asset management &amp; general administration</td>
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<td>4.6 Safety and Security</td>
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Key issues and recommendations

The audit raised three issues. There were three recommendations, of which two were ranked high (critical) priority, meaning “Prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP and may affect the organization at the global level.” These recommendations include actions for the Office to address the declining extrabudgetary (XB) reserve to ensure the Office’s financial sustainability, address obstacles to resource mobilization, and realign project monitoring practices to UNDP policies and procedures.
Financial sustainability at risk. The Office's XB reserve had fallen below the corporate standard of 12 months. The declining reserve was the direct result of dwindling XB income. If there is no significant reduction in XB expenditures, and unless the negative trend in resource mobilization can be reversed, the Office may fully utilize the remaining XB reserve by the end of 2013. As such, the Office's sustainability would be jeopardized. OAI recommends that the Office review its cost structure and significantly reduce its XB expenditures to prevent depletion of its XB reserve.

Inadequate resource mobilization. Resource mobilization has declined drastically due to the exodus of bilateral donors and the Government's reluctance to partner with international organizations, including the United Nations, on activities funded under the European Union (EU) Instrument for Pre-Accession Assistance (IPA). In the last two years, the Office received no funding from the EU, which was one of the largest donors in the Country. The Office has focussed its resource mobilization strategy on securing Government cost sharing at national and local levels, bilateral and multilateral donors, and the private sector. OAI recommends that the Office increase advocacy and networking with the Government, and seek the advice as appropriate from the Regional Bureau, the Bureau of External Relations and Advocacy, and the UNDP Brussels Office.

OAI did not raise a recommendation concerning the outstanding Government contributions towards Local Office Cost (GLOC) balance of 53.7 million as at 31 December 2011, because the issue has been escalated to the Regional Bureau, which is pursuing it further.

Management's comments

The Resident Representative accepted all the recommendations and is in the process of implementing them.

Egbert C. Kaltenbach
Director
Office of Audit and Investigations
I. Introduction

From 4 to 15 June 2012, OAI conducted an audit of UNDP Serbia. The audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*. These Standards require that OAI plans and performs the audit to obtain reasonable assurance on the adequacy and effectiveness of the governance, risk management, and control processes. The audit includes reviewing and analysing, on a test basis, information that provides the basis for our conclusions.

Audit scope and objectives

OAI's audits assess the adequacy and effectiveness of the governance, risk management, and control processes in order to provide reasonable assurance to the Administrator regarding the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and compliance with legislative mandates, regulations and rules, policies and procedures. They are also aimed to assist the management of the Office and other relevant business units in continuously improving governance, risk management, and control processes.

Specifically, this audit reviewed the following areas of the Office -- governance and strategic management, United Nations system coordination, programme activities, and operations. The audit covered relevant activities during the period from 1 January 2011 to 30 April 2012. During the period reviewed, the Office recorded programme and management expenditures totalling $14 million. The last audit of the Office was conducted by OAI in 2007.

II. About the Office

The Office is located in Belgrade, Serbia (the Country). Its programme for the Country focuses on three themes - sustainable development and social inclusion, good governance, and energy and environment. The Office’s programme delivery has declined from $18 million in 2008 to $11 million in 2010 and $9 million in 2011. At the time of the audit, it had 53 ongoing projects working on the three themes. The Office had 26 staff members.

The Country is a middle-income country and is making progress in wide-ranging economic and social reforms. It continues to be challenged by development issues, such as increasing poverty, significant unemployment, low participation of women at all levels of political decision-making, weak public finance management, and a need for improved environmental management. The Country applied for the EU candidate status in 2009 and was accepted as a candidate in 2012.
III. Detailed assessment

1. Governance and strategic management

The Office was under the leadership of a Resident Representative and a Deputy Resident Representative (Programme and Operations). The position of the Assistant Resident Representative (Programme Development Support, Monitoring and Evaluation) was vacant at the time of the audit. The Office underwent a transformation plan in 2010 and in 2011 it was implementing the new structure, redefining roles and processes. At the time of the audit, the Office was revising its Internal Control Framework to reflect the new staffing, capacity, and changes in internal processes, such as bank and payment signatories. In reviewing the Office’s Internal Control Framework, OAI noted that the Resident Representative has delegated the senior manager profile in Atlas to the Deputy Resident Representative and the Assistant Resident Representative (Programme). The Resident Representative asserted that oversight of transactions in Atlas approved by the Deputy Resident Representative and Assistant Representative was exercised by signing the contracts/agreements.

The Office had an outstanding GLOC balance of $3.7 million as of 31 December 2011. With the exception of $10,000 paid in 2012, the Government has not paid GLOC in the last decade. GLOC refers to the contributions of host governments towards the costs of UNDP country offices in accordance with the standard basic assistance agreements that govern UNDP operations in programme countries. The Government has not paid its contributions despite regular discussions and negotiations led by the Office over the last 12 years with the highest levels of Government. As the outstanding GLOC is beyond the control of the Office, the Office has escalated the issue to the Regional Bureau for Europe and the Commonwealth of Independent States, which is pursuing the issue further. In view of this, OAI is not raising a recommendation. No other reportable issues were identified.

Issue 1 Financial sustainability at risk

Resource mobilization is fundamental to the Office’s sustainability. UNDP requires country offices to maintain a minimum of 12 months of XB reserve. The Office’s XB reserve has fallen from 16 months in 2009 to just 11 months in 2011. The declining reserve is the direct result of dwindling XB income. Since 2007/2008, when the development project portfolio was at its highest point, the mobilization of non-core resources fell from more than $27 million to $14.6 million in 2009; $5.2 million in 2010; and $4.3 million in 2011. The Office asserted that resource mobilization in 2012 stood at $5.8 million exceeding the target of $5.0 million. Despite its declining income, the Office costs remained at the same level since 2008 at around $1 million in 2008; $1.2 million in 2009; $0.9 million in 2010; and $0.9 million in 2011. They have exceeded the XB income of about $0.9 million in 2009; $0.75 million in 2010; and $0.52 million in 2011, thus gradually absorbing the XB reserve.

If there is no significant reduction in XB expenditures, and unless the negative trend in resource mobilization can be reversed, the Office may fully utilize the remaining XB reserve by the end of 2013, based on the Office’s conservative XB reserve forecast for 2012/2013. As such, the Office’s sustainability is jeopardized.

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<th>Priority</th>
<th>High (Critical)</th>
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**Recommendation 1:**

The Office should review its cost structure and significantly reduce its extrabudgetary expenditures in order to prevent depletion of its XB reserve.
The Office worked actively with the Regional Bureau and other headquarters units in 2009 and 2010 to conceive a transformation plan that was implemented in 2011. The Office then drafted an action plan, which was discussed with the Regional Bureau and submitted formally in September 2012. It revised the action plan based upon further consultations with different headquarters units and the Regional Director. The action plan analysed the financial situation, past and future prospects, and suggested concrete measures to ensure financial sustainability in the mid-term, as well as an increase in XB reserves from 2013 to 2015.

2. United Nations system coordination

The United Nations Country Team (UNCT) consisted of 19 members: UNDP, FAO, International Criminal Tribunal for the former Yugoslavia, IFC, ILO, IMF, IOM, UN Women, UN-Habitat, UNFPA, UNHCHR, UNHCR, UNICEF, United Nations Office in Belgrade, UNODC, UNOPS, UNWTO, World Bank, and WHO. OAI met with three United Nations agencies. At the time of the audit, there were six joint programmes totalling $22 million in progress, plus another 11 joint programmes totalling $49 million that were awaiting approval and funding. No reportable issues were identified.

2.1 Development activities

The United Nations Development Assistance Framework (UNDAF) for 2011 to 2015 is based on the Country’s National Development Strategy. OAI reviewed the UNDAF and its formulation process; assessed the joint programme formulation processes; ascertained the coherence between UNDAF outcomes and programme results; reviewed the quality of joint programming documents and reporting; and assessed the joint programme monitoring and evaluation and coordination mechanisms. No reportable issues were identified.

2.2 Resident Coordinator Office

OAI met with three United Nations agencies, Resident Coordinator Office (RCO) staff, and donors. It discussed the services provided by the RCO, joint programming, and the work of the UNCT. OAI also reviewed the minutes of UNCT meetings, the RCO work plans and annual reports, the staffing of the RCO, and two joint programmes. On the two joint programmes, United Nations agencies pointed to a need to improve approaches to programming and communication between agencies to achieve better coordination and reduce the operational costs incurred by multiple financial and reporting systems. The Office has agreed to look into the programming and reporting arrangements for the future design of joint programmes. No reportable issues were identified.

2.3 Role of UNDP - “One UN”

This area was not applicable as the Country is not a “One UN” country.

2.4 Harmonized Approach to Cash Transfers

The Harmonized Approach to Cash Transfers has not yet been implemented in the Country. A macro-assessment showed that the Serbian State Audit Institution, which is supposed to be responsible for auditing partners under the Harmonized Approach to Cash Transfers, does not yet have the necessary capacity to undertake the assurance role. The Office has therefore put in place a capacity building project to assist the audit institution, which is expected to attain the necessary capacity in 2013 once the audit institution is fully staffed. In view of the appropriate action taken by the Office in this regard, and considering that no reportable issues were identified, this area is rated “satisfactory”.

Management Comments:  __X__ Agreed  ____Disagreed
### 3. Programme activities

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<tr>
<th>3.1 Programme management</th>
<th>Partially Satisfactory</th>
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The Office began its new programming cycle in 2011. The Country Programme Document (CPD), 2011 to 2015, focuses on three major themes: namely sustainable development and social inclusion; good governance; and energy and the environment. OAI reviewed the CPD; the functioning of Outcome Boards and their composition; the consistency of the development projects with the CPD; and the consistency of the CPD with the UNDAF; the annual reporting; and the alignment of development projects in Atlas. No reportable issues were identified.

The Office adopted a **good practice** of presenting the Government with estimates of anticipated Target for Resource Assignments from the core resources over the next three years, and agreeing with the Government on how best to utilize the resources. The practice has facilitated co-financing of activities by the Government, as well as inter-ministry coordination to maximize the effects of UNDP's work in the Country.

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<th>3.2 Partnerships and resource mobilization</th>
<th>Partially Satisfactory</th>
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**Issue 2**  
**Inadequate resource mobilization**

The financial sustainability of UNDP country offices depends on their ability to mobilize resources and establish effective partnerships. Resource mobilization fell from $27.1 million in 2007 and $27.2 million in 2008 to $14.6 million in 2009; $5.2 million in 2010; and $4.3 million in 2011. The Office pointed out that the decline over the past four years reflects the exodus of bilateral and multilateral donors, along with the Government’s reluctance to partner with international organizations, including the United Nations, on activities funded under the EU Instrument for Pre-Accession Assistance (IPA), and limitation of Government cost-sharing due to its widening budget deficits.

Since the European Agency for Reconstruction was closed in 2008, the Office has not mobilized funds locally under IPA. The Office indicated that it had mobilized resources from EU central sources and the EU Council. In 2011, the Office submitted six proposals under IPA that were not approved. In discussion with OAI, the Office indicated progress in mobilizing resources on Government cost-sharing at national and local level. The Office continued to work and consult actively with the Regional Bureau; the Bureau of External Relations and Advocacy; the UNDP Brussels Office; the Government; bilateral and multilateral donors, and the private sector.

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<th>Priority</th>
<th>High (Critical)</th>
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**Recommendation 2:**

In revising its resource mobilization strategy, the Office should increase advocacy and networking with the Government, and seek the advice as appropriate from the Regional Bureau, the Bureau of External Relations and Advocacy, and the UNDP Brussels Office.

**Management Comments:** __X__ Agreed  ____Disagreed

The Office will continue to implement its resource mobilization strategy aimed at increased advocacy and networking towards Government cost sharing at national and local levels, and expanded partnerships with the private sector. The Office will also sustain efforts to mobilize resources from bilateral and multilateral donors and solicit internal advice and support as needed.
3.3 Project management  Partially Satisfactory

**Issue 3**  Inappropriate practices on project monitoring

UNDP policies and procedures require that controls be put in place to monitor the effective implementation of projects. Practices by the Office on project monitoring include:

- Usage of generic Atlas-generated annual work plans did not include the activities to be implemented, timelines, or indicators to enable more effective project monitoring;

- Field visits conducted on five sampled projects could have been better documented through brief and action-oriented reports as evidence of project oversight instead of the current practice of using email and verbal communication. The need for better documentation did not suggest that proper oversight had been carried out;

- The Atlas project management module could be better used by including project elements, such as activity summaries, purpose, quality criteria, issue and risk logs. Nonetheless, the audit noted that the Office had a good practice of keeping a log of issues identified by nationally implemented project audits to share the lessons learned with other projects; and

- Approval of substantive project revisions based on project board decisions instead of decisions by the Local Project Appraisal Committee was questionable for two reasons. Project board members might not be the same people as those that approved the project document and may or may not be in a better position to endorse evidence of substantial revisions in the project document. An example of substantive revision in one sampled project included the end date of a project shown as extended from April 2012 to December 2014, while the budget was increased to $7.6 million from the original budget of $2.2 million.

Inadequate monitoring and accountability could result in projects missing targets, or loss of resources, which may negatively affect UNDP’s reputation as a credible development partner.

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<th>Priority</th>
<th>Medium (Important)</th>
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**Recommendation 3:**

The Office should revisit its current practices on project monitoring to be more consistent with UNDP policies and procedures, particularly on using the prescribed format for annual work plans, documenting field visits, and reconvening the Local Project Appraisal Committee on substantive project revisions.

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<th>Management Comments:</th>
<th>X Agreed</th>
<th>Disagreed</th>
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4. Operations  Satisfactory

4.1 Human resources  Satisfactory

The Office had 26 staff members comprising four international staff; six national officers; and 16 general service staff. In addition, during the audit period, 55 Service Contract holders and 56 Individual Contract holders were working on projects. The human resources function was performed by a Human Resources Associate who was
supported by an Administrative Associate. OAI reviewed a sample of eight staff, 17 Service Contract holders, and 13 Individual Contract holders to verify the relevant recruitment and selection processes. No reportable issues were identified. OAI also selected a sample of four staff to test the separation process. The Office promptly processed separation and accurately calculated benefits upon separation. The Office has agreed to rectify an error made in granting an increment to four staff, totalling about $1,900, during the transformation process.

The Results and Competency Assessment is an assessment of an individual’s contributions towards corporate results, as expressed in the Office’s work plans, and constitutes a vital tool for performance improvement and career development. At the time of the audit, the 2011 Results and Competency Assessment was still in progress for seven staff (or 29 percent of total staff). The Office agreed to complete them by 30 June 2012. No reportable issues were identified.

### 4.2 Finance

Satisfactory

The Finance Unit had two staff members. The Office recorded 6,240 vouchers with a value of $10 million in 2011, and 1,628 vouchers with a value of $2 million in the first four months of 2012. OAI reviewed 30 disbursement vouchers with a total value of $1 million, which represented about 10 percent of the value of vouchers during the review period. The Office is planning to reduce the number of bank signatories in the revised Internal Control Framework. No reportable issues were identified.

### 4.3 Procurement

Satisfactory

The procurement function was performed by a Procurement Associate supported by an Administrative Associate, who also performed human resources functions. The Office recorded 988 purchase orders with a value of $5 million in 2011 and 197 with a value of $1 million in the first four months of 2012. OAI reviewed the procurement process by interviewing Office staff and testing a sample of 20 purchase orders valued at $1 million, or about 16 percent of the total value of items procured using purchase orders during the audit period. The Office agreed to improve the evaluation of vendor performance once the goods or services are delivered. No reportable issues were identified.

### 4.4 Information and communication technology

Satisfactory

OAI’s review showed that the disaster recovery (business continuity) plan, data back-up procedures, use of licensed software, and procedures protecting information technology systems from viruses and attacks from hackers were adequate. The Office has agreed to improve the planning process relating to information and communication technology activities by including the budget and implementation period in the information and technology plan. No reportable issues were identified.

### 4.5 Asset management and general administration

Satisfactory

The audit reviewed the administration of the Office premises, travel, and asset and records management. The Office premises were shared with other four United Nations agencies and UNDP projects. The Office operated three vehicles for office use and owned assets valued at $0.3 million at 31 December 2011. OAI physically verified the existence of assets by sampling 18 assets valued $0.2 million. The review showed that assets older than 10 years and valued at $20,000 were still in use.

The Office has been renting a commercial property and has paid about $1.4 million between 2000 and the time of the audit. Continuous efforts to obtain rent-free office premises from the Government have not been
successful. At the time of the audit, the Office initiated a procurement process to identify better value-for-money solutions in the local rental property market. No reportable issues were identified.

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<th>4.6 Safety and Security</th>
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A minimal security level (1) was in effect for the North and Central Serbia, and a low security level (2) was in effect for the South-West and Southern Serbia. The UNDP Resident Representative was the Designated Official responsible for managing the security of the United Nations in the Country. The United Nations Department of Safety and Security’s Compliance, Evaluation and Monitoring Unit, visited the Office in January 2010 and made 15 recommendations for improvement, all of which were fully implemented in 2011. The last Security Risk Assessment performed by the United Nations Department of Safety and Security in March 2011 did not identify high residual risk levels in any area. No reportable issues were identified.
ANNEX I. Definitions of audit terms - Ratings and Priorities

A. AUDIT RATINGS

In providing the auditors’ assessment, the Internal Audit Services of UNDP, UNFPA, UNICEF, and WFP use the following harmonized audit rating definitions. UNDP/OAI assesses the country office or audited HQ unit as a whole as well as the specific audit areas within the country office/HQ unit.

- **Satisfactory**
  Internal controls, governance and risk management processes were adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.

- **Partially Satisfactory**
  Internal controls, governance and risk management processes were generally established and functioning, but needed improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.

- **Unsatisfactory**
  Internal controls, governance and risk management processes were either not established or not functioning well. The issues were such that the achievement of the overall objectives of the audited entity could be seriously compromised.

B. PRIORITIES OF AUDIT RECOMMENDATIONS

The audit recommendations are categorized according to priority, as a further guide to UNDP management in addressing the issues. The following categories are used:

- **High (Critical)**
  Prompt action is required to ensure that UNDP is not exposed to high risks. Failure to take action could result in major negative consequences for UNDP and may affect the organization at the global level.

- **Medium (Important)**
  Action is required to ensure that UNDP is not exposed to significant risks. Failure to take action could result in negative consequences for UNDP.

- **Low**
  Action is desirable and should result in enhanced control or better value for money. Low priority recommendations, if any, are dealt with by the audit team directly with the Office management, either during the exit meeting or through a separate memo subsequent to the fieldwork. Therefore, low priority recommendations are not included in this report.