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والزراعة  
للأمم المتحدة

联合国  
粮食及  
农业组织

Food  
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Agriculture  
Organization  
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the  
United  
Nations

Organisation  
des  
Nations  
Unies  
pour  
l'alimentation  
et  
l'agriculture

Organización  
de las  
Naciones  
Unidas  
para la  
Agricultura  
y la  
Alimentación

## CONFERENCE

**Thirty-fourth Session**

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**Audited Accounts – FAO 2004-20005  
Part B – Report of the External Auditor**

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**REPORT OF THE EXTERNAL AUDITOR  
ON THE FINANCIAL STATEMENTS OF  
THE FOOD AND AGRICULTURE ORGANIZATION  
OF THE UNITED NATIONS  
FOR THE FINANCIAL PERIOD 1 JANUARY 2004 TO 31 DECEMBER 2005**

**PART I**

**GENERAL**

**Introduction**

1. The present report is being submitted on the results of the audit of the Food and Agriculture Organization (FAO) of the United Nations for the biennium 2004-2005. The scope of the audit was decided in compliance with Financial Regulations 12.1 to 12.10 of the Organization and the additional Terms of Reference governing External Audit appended thereto.
2. The present report, which is written in English, includes my observations on the Financial Statements of the Organization for the period 2004-2005 which are reported in Part I of this Report.
3. Management reviews of the working of the Organization, in respect of Official Travel, Contracts for Local Services, Treasury Operations in Headquarters and Human Resource Management were carried out during the biennium. In addition, two Regional Offices (RO) and nine FAO Representations (FAOR) were visited by audit. These audits covered regularity of financial transactions, management matters and project management.
4. My observations on the management reviews on Treasury Operations and Human Resource Management and results of audit of the field offices are reported in Part II of this report. Following decision taken in the 107th session of the Finance Committee, the reports on the management reviews of Official Travel and Contracts for Local Services were submitted to the Committee in its 110th session. These two reports are now reproduced *in toto* in Part III of this report.
5. My observations on losses written off, ex-gratia payments and cases of fraud or presumptive fraud during the biennium are included in Part IV of this report.

6. The present report also contains my recommendations arising from my observations. Following past practice, I have categorized these recommendations as Fundamental, Significant and Meriting attention.<sup>1</sup>

#### Summary of Recommendations

		Priority	TimeLine
1	I recommend that the Organization finds realistic and long term ways to fully fund the unfunded part of the liability of After Service Medical Coverage within the amortization period. (Paragraph 24)	Merits Attention	Ongoing
2.	I recommend that the Organization should determine the minimum number of posts at different levels required by Finance Division to maintain the internal financial controls at a satisfactory level and then provide for them.(Paragraph 31)	Significant	December-2006
3	I recommend that concrete steps be taken to ensure that scaling down of local audit does not have any adverse impact on the control environment in the decentralized offices. I further recommend that the Finance Committee should be periodically informed about the extent of scaling down and its impact.(Paragraph 32)	Significant	December 2007-
4	I recommend that the Organization continues to pay close attention to the liquidity crisis so that timely decisions can be taken to regulate delivery of programmes, should the availability of cash fall far short of the requirements. Since a major share of the regular programme expenditure relates to salaries and other committed expenditure like maintenance of office installations, the Organization should make efforts to develop a contingency plan to face the situation. If delivery of Regular Programmes continues to be linked solely to appropriations, it will become unsustainable in a scenario of serious cash crisis. (Paragraph 51)	Significant	Ongoing
5	I recommend that the Organization should invariably credit any future payment of arrears in contributions solely towards the outstanding arrears so that such arrears are used only to cover past budget expenditures. When received, arrears should not be considered as a new source of Funds but should be used to improve the position of the General Fund.(Paragraph 53)	Fundamental	Ongoing
6	I recommend that the Organization considers the issue of aligning disbursement of appropriations of TCP with receipt of contributions in view of the cash crisis and arrears of payment of contributions.(Paragraph 58)	Merits Attention	December 2007
7	I recommend that, as planned, the Organization implements the third tier of the banking strategy and completes the	Merits Attention	December 2007

<sup>1</sup>**Fundamental** : Action is considered imperative to ensure that the Organization is not exposed to high risks. Failure to take action could result in serious financial consequences and major operational disruptions.

**Significant** : Action is considered necessary to avoid exposure to significant risks. Failure to take action could result in financial consequences and operational disruptions.

**Merits Attention**: Action is considered desirable and should result in enhanced control or better value for money.

	<b>process of rationalization of banking arrangements. The Organization should move towards a regime of total Electronic Data Interchange and e-banking.( Paragraph 72)</b>		
<b>8</b>	<b>In view of the criticality of HRMM to HRMS, I recommend that the Organization continues to pay adequate attention and deploys adequate resources to ensure that no delay takes place in development of HRMM. Any delay will also increase the project cost of HRMS. (Paragraph 83)</b>	<b>Fundamental</b>	<b>December 2006</b>
<b>9</b>	<b>I recommend that the Organization continues to monitor closely the progress regarding adequate technological infrastructure for HRMM and HRMS to be successful both at Headquarters and at the field level. (Paragraph 89)</b>	<b>Significant</b>	<b>December 2006</b>
<b>10</b>	<b>I recommend that the staffing issues for the HRMS project be addressed comprehensively and in a consistent manner so that suitable human resource is provided to the project to enable it to complete the remaining phases in time.(Paragraph 96)</b>	<b>Significant</b>	<b>December 2006</b>
<b>11</b>	<b>I recommend that the Organization should establish a comprehensive plan for user involvement - particularly users from decentralized offices- so that no occasion arises which would require major and costly changes in the system at a later date. Adequate user involvement and smooth change management is critical for the system.(Paragraph 103)</b>	<b>Significant</b>	<b>December 2006</b>
<b>12</b>	<b>I recommend that in view of its importance, user training for HRMS should be closely monitored.(Paragraph 107)</b>	<b>Merits Attention</b>	<b>December 2006</b>
<b>13</b>	<b>I recommend that the Organization continues its efforts to develop management skills among the personnel. It should also carefully evaluate and define the profiles of its professional staff to ensure that its high level expertise and leadership skills, international character, and ability to support field offices are not weakened. (Paragraph 113)</b>	<b>Merits Attention</b>	<b>Ongoing</b>
<b>14</b>	<b>I recommend that the Organization should reorient its recruitment strategies to ensure that more women are recruited in the professional posts, especially in the higher positions; while giving due emphasis to developing nations where the representation levels are even lower.(Paragraph 118)</b>	<b>Merits Attention</b>	<b>Ongoing</b>
<b>15</b>	<b>In view of the seriousness of the irregularities in the SPFS project in FAOR Nigeria, I recommend that the Organization should establish a time bound programme to set right, to the extent possible, the irregularities that already have taken place. It should also consider inclusion of internal control mechanisms in the project formulation of such high value projects in future and all such internal control mechanisms should be functional from the beginning of the projects. (Paragraph 126)</b>	<b>Significant</b>	<b>December 2006</b>

**Summary of Recommendation on Part III (Reports that have been submitted to the Finance Committee and reproduced in this report in toto.)**

<b>Recommendation</b>	<b>Category</b>	<b>Timeline</b>
16. I recommend that the Organization concludes the tender process and finalises the contract as soon as possible to avoid incurring additional costs that it has been burdened with. (Paragraph 139).	Fundamental	Immediate
17. I recommend that the manual section be revised to clarify the specific definition of journey time. I also recommend that Organization should develop mechanisms to check, at least on a sample basis, the application of the Organization's rules. (Paragraph 144).	Merits Attention	Immediate
18. I recommend that the Organization continues its efforts to bring down the number of Prepaid Ticket Advices in the interest of economy. (Paragraph 148)	Merits Attention	December 2005
19. I recommend that the Organization continues its efforts for staff certification of travel within the prescribed period. I also recommend that AUD should conduct the first review of the lump sum payments and the documentations early, so that the Organization can evaluate the effectiveness of the procedures and risks, if any, such procedures pose to the control environment. (Paragraph 154).	Significant	December 2005
20. I recommend that the Organization continues with the process for replacement of the travel system in order that it fully meets the current and future requirements of the Organization. I also recommend that adequate resources may be provided for having a web based travel monitoring package fully integrated with Oracle Financial Applications. (Paragraph 167).	Significant	December 2005
21. I recommend that the task of configuring the travel expense list may be completed as early as possible and suitable guidelines issued (Paragraph 171).	Merits Attention	December 2005
22. I recommend that, in view of the changed circumstances, the Organization develops comprehensive policy/guidelines covering issues such as impact on costs, impact on staff, quality measurement indicators and decentralization of services for approval at the appropriate level, including if required, from the Governing Bodies, to govern its outsourcing operations both in Headquarters and in the decentralized offices. (Paragraph 182).	Significant	By end of 2006
23. I recommend that the Organization should amend provisions in the Manual to include costs as an important factor for award of any contract. Technical parameters and costs should have a balanced weightage to ensure value for money for the Organization (Paragraph 188).	Fundamental	By end of 2006
24. I recommend that the Organization develop and document principles determining requirements of technical proposals or otherwise. A minimum set of parameters for technical evaluation taking into account the good practices of other international Organizations should also be developed and	Significant	By end of 2006

	<b>documented. Additional guidelines as necessitated by complexity of specific contracts should be supplementary. (Paragraph 193).</b>		
25	<b>I recommend that the Organization should continue its efforts towards strengthening the vendors' database to increase response to its invitations for bids. (Paragraph 199).</b>	<b>Merits Attention</b>	<b>By end of 2006</b>
26	<b>I recommend that the Organization should impress upon the requisitioning divisions to draw up specifications with greater care. (Paragraph 205).</b>	<b>Significant</b>	<b>By end of 2006</b>
27	<b>Appreciating that checking each supporting document together with invoices may be a costly affair involving additional staff, I recommend that on a random sample basis, periodical monitoring should be conducted with a view to ensuring that performance of the contract adheres to the conditions therein. (Paragraph 208).</b>	<b>Merits Attention</b>	<b>Ongoing</b>
28	<b>I recommend that all cases of waivers of tendering procedures in printing contracts should be regularized without delay and in future, such waivers should be approved by the designated committee (Paragraph 211).</b>	<b>Merits Attention</b>	<b>Ongoing</b>
29	<b>I recommend that the Organization make special efforts to ensure that the originating divisions are aware of the cost implications for last minute-changes after materials are handed over to the printer (Paragraph 213).</b>	<b>Merits Attention</b>	<b>By end of 2006</b>

#### **Audit of Financial Statements**

7. The audit of financial statements was carried out 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 and conforming to International Standards on Auditing. These standards require that the audit be planned and carried out to obtain reasonable assurance that the financial statements are free from material misstatements. The Director General is responsible for preparing these statements and I am responsible for expressing an opinion on them.

8. The audit included an examination, on a test basis and as considered by me to be necessary in the circumstances, of evidence supporting the amounts and disclosures in the financial statements. It also included assessing the accounting principles used and significant estimates made by the Director General, as well as evaluating the overall presentation of the financial statements.

9. In addition, I was requested to perform audit of the following separate financial statements for the programmes implemented in cooperation with or on behalf of other Organizations, namely:

- FAO/UN Population Fund (UNFPA) Biennium Status of Funds and Schedule 1- Biennial Expenditure Statement as at 31 December 2005;
- FAO/UN Development Programme (UNDP) Status of Funds and Schedule 1- Schedule of Expenditure on Projects executed by FAO, as at 31 December 2005.

10. The audit enabled me to issue an unqualified audit opinion on the financial statements of the Food and Agriculture Organization of the United Nations for the biennium 2004-2005.

#### **Previous recommendations**

11. I have not separately included comments on actions taken on the previous recommendations except when the context demands so. This is because the Finance Committee has already developed a mechanism of following up in every session all previous recommendations. Verification by the external audit of the action taken is also reported to the Finance Committee through this mechanism.

### **FINANCIAL MATTERS**

#### **Financial position of the Organization**

12. The financial position of the Organization sharply deteriorated during the biennium 2004-05. The net shortfall of income over expenditure of the General and Related Funds was US\$ 85 million. This was in contrast to the preceding biennium which ended with income in excess of expenditure amounting to US\$ 13.4 million. The shortfall was primarily due to significant increase of US\$ 72 million in provision for delays of contributions in contrast to the reduction of such provision by US\$ 64.6 million in 2002-2003. The other significant factors were transfer of investment income of US\$ 36.6 million to Long Term investment to meet staff related liabilities as authorized by Conference Resolutions 10/1999 and 10/2001 and charges of US\$ 33 million to amortize staff related liabilities. Deferred income of US\$ 26.5 million representing the carried forward appropriations for TCP and expenditure of US\$ 31.3 million met out of one time arrear allocation prevented the shortfall from nosediving further.

13. As a result of the shortfall, the deficit in the end of the biennium fund balances under General and Related Funds deteriorated significantly. It stood at US\$ 124.8 million as at the end of biennium 2004-2005 declining sharply from the deficit of US\$ 90.1 million as at the end of the biennium 2002-2003. Moreover, the deficit at the end of 2002-2003 did not include any transfer from Working Capital Fund and Special Reserve Account which had positive balances of US\$ 25.2 million and US\$ 23 million respectively. In 2004-2005, the Organization had to resort to internal borrowing from these two Funds, wiping out the balances of these as at the end of the biennium. US\$ 25.2 million was transferred from Working Capital Fund and US\$ 10.3 million was transferred from Special Reserve Account.

14. As regards Trust and UNDP Funds, the Organization had an excess of income over expenditure of US\$ 14.3 million in 2004-2005. This represented the interest income on the cash, term deposits and short term investments. The entire amount has been transferred to the donor accounts, thus leaving the Fund balance unchanged at the end of the biennium.

15. The Organization's assets under General and Related Funds on 31 December 2005 stood at US\$ 288.2 million, declining by 4.8 per cent from assets of US\$ 302.6 million on 31 December 2003. Cash and term deposits declined from US\$ 37.5 million on 31 December 2003 to US\$ 30.8 million on 31 December 2005, short term investment from US\$ 60.4 million on 31 December 2003 to nil on 31 December 2005. The decline was partially offset by increase of US\$ 4.6 million in receivables and that of US\$ 48.1 million in long term investments. These figures, however, need to be viewed in the light of the fact that the Organization ended the biennium with outstanding borrowings from the banks amounting to US\$ 71 million to meet expenditure under General Fund.

16. The liabilities of the General and Related Fund increased from US\$ 344.5 million on 31 December 2003 to US\$ 402.9 million representing an increase of 17 per cent. The increase was primarily due to outstanding bank borrowings of US\$ 71 million and increase in recorded liabilities on staff related schemes from US\$ 182.2 million on 31 December 2003 to US\$ 239.6 million on 31 December 2005.

17. During the biennium, a management review was conducted on Treasury operations, which included cash management and the cash crisis faced by the Organization. My findings are reported in Part II of this report. My observations on the staff related liabilities are also reported subsequently.

18. Under the Trust and UNDP funds, however, the assets went up from US\$ 406.1 million on 31 December 2003 to US\$ 462.2 million on 31 December 2005 representing an increase of 13.8 per cent. The assets comprised US\$ 80 million in cash and term deposits and US\$ 368.4 million in short term investments. The liabilities of US\$ 451 million on 31 December 2005 represented US\$ 384.3 million of contributions received in advance and US\$ 66.8 million of unliquidated obligations.

19. In the first quarter of 2006, with arrears of assessment having been paid by major contributors, the Organization has been provided with some relief from the cash crisis. However, the fundamentals of the financial position of the Organization continue to be very weak.

#### **Staff Related Liabilities**

20. The Organization faces four types of staff related liabilities. During the past few biennia, it has arrived at the present value of the liabilities through actuarial valuation by an external actuarial agency. However, much of these liabilities remain unrecorded in the financial statements, though they have been disclosed in the notes to the financial statements. At the end of the biennium 2004-2005, the Organization has been able to fully record two liabilities namely staff compensation payments (US\$ 16.6 million) and separation payments (US\$ 77.9 million).



Full actuarial present value of US\$ 25.9 million on account of terminal payments to the staff remains unrecorded.

21. Most significant, however, is the liability on account of after service medical coverage. The actuarial present value of the liability at the end of the biennium was US\$ 533.4 million, an increase of US\$ 219.6 million from the previous biennium. The recorded liability, however, is only US\$ 145.1 million. The unrecorded liability on this account has thus increased to US\$ 388.3 million at the end of 2004-2005 from US\$ 202.9 million at the end of 2002-2003. The increase in the present value of this liability was due mainly to the strengthening of the Euro exchange rate against the US Dollar since almost two thirds of the liability is in Euro. Other factors contributing to the higher liability included reduction in the assumed annual discount rate from 5.5 per cent in the previous biennium to 4.5 per cent in the current biennium, increase in the assumed medical inflation rate from 4.5 per cent in the previous biennium to 6.5 per cent in the current biennium and the impact of updated mortality tables.

22. The Organization has earmarked the long term investments to extinguish various liabilities in terms of Conference resolution 10/1999 and 10/2001 and recorded the liabilities to the extent earmarked investments are available. In addition, in 2003, the Conference agreed to fund the amortization of liability towards After Service Medical Coverage (ASMC) with an additional assessment of US\$ 14.1 million beginning from biennium 2004-2005. However, the additional assessment has now proved to be completely inadequate as the present value of the liability has increased dramatically.

23. Against the additional assessment, the Organization transferred US\$ 6.3 million on 30 June 2005 and another US\$ 5.2 million on 31 December 2005 to Long Term investment portfolio. The shortfall was due to non-payment of assessments by some of the member nations.

24. **I recommend that the Organization finds realistic and long term ways to fully fund the unfunded part of the liability of After Service Medical Coverage within the amortization period.**

25. The Director General, in response to the draft report issued to him, stated that the issue of unfunded liabilities for the ASMC is a long standing UN system wide problem which to varying degrees is being addressed by agencies and the UN itself. He emphasized that the Member States bear collective responsibility to address and fund such liabilities and the matter has been discussed at length during several Finance Committee and Council sessions. Further convergence on this issue in the UN system is expected, as the UN has now brought the matter to the General Assembly with proposals on how to begin funding the ASMC for the UN. FAO was among those Organizations, he stated, which have made considerable progress in recording and funding of ASMC and it was expected that the Member States would continue to aim for a long term funding

approach with additional assessments which were kept separate from the biennial budgetary appropriations.

### **Internal Financial Controls**

26. In his report for the biennium 2000-2001, the external auditor commented comprehensively on the Organization's internal controls. His findings included, inter-alia, insufficient staffing of the Finance Division. He also noted the declining budget levels to the division from as early as 1992-93. The Finance Committee, time and again, has emphasized the importance of strengthening internal controls and adequate staffing of the Finance Division.

27. In the revised Programme of Works and Budget (PWB) 2006-2007, further cuts in budget not only for the Finance Division but for other organs of internal control namely internal audit and local audit have been proposed. The Organization has stated that "post abolitions and cuts in non-staff resources will adversely impact internal financial controls, compromising the Organization's capacity to produce accurate, timely and complete accounts, and lowering service standards." (Paragraph 226 of Revised Programme of Works and Budget 2006-2007).

28. At the end of 2005, the actual staffing levels of Finance division amounted to a headcount of 104 comprising 70 encumbered posts, 15 short term posts and 19 PSA/TAP. The Organization confirmed that the reduced budget level and loss of funding to the division from one time allocations of arrears would reduce the headcount to 80, comprising 70 encumbered posts and 10 short term posts. This represents more than 20 per cent reduction in one biennium.

29. The local audit programme, which has acquired considerable importance in view of the decentralization and delegation of powers to field offices, has also suffered from reduced budget levels. In 2005, issuance of contracts for local audit had to be suspended from October due to lack of funds. The Organization apprehended that due to reduced budget level, the contracts may have to be stopped sometime from the middle of the year 2006.

30. While appreciating that appropriations as approved by the Conference for Regular Programme for 2006-2007 will lead to a real reduction of 5.2 per cent from the previous biennium, I consider the reduction in posts in AFF and reduction of funding of local audit pose threats to internal financial controls.

31. **I recommend that the Organization should determine the minimum number of posts at different levels required by Finance Division to maintain the internal financial controls at a satisfactory level and then provide for them.**

32. **I recommend that concrete steps be taken to ensure that scaling down of local audit does not have any adverse impact on the control environment in the decentralized offices. I**

**further recommend that the Finance Committee should be periodically informed about the extent of scaling down and its impact.**

33. Every internal control system needs ownership and it is the senior management which normally assumes such ownership. Approval of the Governing Bodies to the Programme of Works and Budget which envisages adverse impact on the Organization's internal financial controls compromising the capacity to produce accurate, timely and complete financial statements and lowering of service levels diffuses such ownership of the internal financial control system between the Governing Bodies and senior management.

34. The Director General in his response to the draft audit report issued to him noted the concerns expressed above. He recognized the fundamental roles of the Finance Division, the Office of the Inspector General and the Local Audit Programme in a properly functioning system of internal control, which was essential to ensure a proper framework of delegation and accountability. In the reform proposals which will be considered by the Council in November 2006, he has made proposals to provide resources to: (1) strengthen administrative support in field locations, whereby 24 General Service positions have been reclassified since PWB 2004-2005 to national professional positions; (2) re-instate nearly US\$ one million per biennium for the local audit programme and (3) provide a further US\$ 340,000 since the Revised PWB 2006-2007 to the Office of the Inspector General and US\$ 1.1 million to bolster further internal control mechanisms in the Finance Division.

### **Matters arising out of audit of the financial statements**

#### **Accounts Receivables**

35. On 31 December 2005, the accounts receivables stood at US\$ 48.6 million. However, out of this, an amount of US\$ 29.6 million represented advances and prepayments to the staff and Consultants. Due to Oracle functionality, such amounts are treated as receivables pending submission of adjustment bills. In reality, it would be reasonable to assume that most of this amount will be adjusted, once the adjustment bills are submitted by the concerned staff members.

36. In my report for the biennium 2002-2003, I had pointed out lack of timely adjustments of travel advances to the consultants on completion of travel. It was noted in audit that such balances have reduced during the biennium. With regard to current processing of travel related advance payments and related recovery actions, stricter application of existing recovery procedures is being introduced by the Shared Services Centre to ensure that outstanding advances are recovered when due and thereby ensure that there is no build up of overdue balances as in past periods.

## **PART II**

### **MANAGEMENT MATTERS**

#### **TREASURY OPERATIONS**

37. A review of the Treasury Operations in the Organization was conducted in audit in December 2005 and January 2006.

##### **Introduction**

38. The Treasury Operations Branch (AFFT) administers the inflow, disbursement and investment of the Organization's financial assets in compliance with policy guidelines, references and standards. The Treasury Unit fulfils this responsibility for HQ, regional and field offices. Treasury Operations are governed by the Financial Regulations, supplemented by Financial Rules (Manual Section 202).

39. The primary objective of the Organization's Treasury Management is preservation of the Organization's investments and maximising returns on them in a prudent and cost-effective manner. Investments are the most significant assets of the Organization constituting 92 per cent of its total assets. Treasury Unit is also vested with the important function of liquidity management, which becomes critical when the Organization is facing a serious liquidity crisis. Lastly, the Unit is also responsible for currency management and banking arrangements.

40. The investment management of FAO is outsourced, whereby the investible funds are held by a custodian and investments are managed by two investment management firms. The overall control and monitoring of the external managers is the responsibility of Treasury.

##### **Scope of Audit and Audit Approach**

41. The review covered the following areas of treasury operations:

- (a) Cash management,
- (b) Investment management,
- (c) Performance of Split Assessment
- (d) Banking operations

42. The liquidity position including monthly cash flow forecasts from 2003 to 2005 relating to General Fund were examined in audit. The overall financial position of the Organization particularly with regard to availability of cash to deliver its regular programmes was scrutinized in audit. The concerns expressed by the Governing Bodies, the recommendations of the Advisory Committee on investments and the findings of various studies conducted were considered while identifying the areas for audit examination.

## **Cash Management for the General Fund**

### **Cash Forecasting**

43. Analysis of the cash flow forecast and actual cash flow for the years 2003, 2004 and 2005 indicated that while actual payments were in line with the forecasts, the receipts - 90 per cent of which consisted of contributions by member nations - were unpredictable. The unpredictability of receipts has adversely affected the liquidity management in the Organization.

### **Liquidity Position**

44. The liquidity position during 2003 was manageable although overall liquidity had been reduced considerably during the last quarter of the year. However, the cash balances at the beginning of each month were sufficient to meet payments during the month. The position deteriorated further during 2004 and there was a liquidity crunch during the period September through December. During this period the Organization had to borrow for the first time from the banks against the lines of credit available to it. However, the situation improved when a large part of contributions was received.

45. The situation deteriorated significantly during 2005 with serious liquidity problems faced during the second half of the year. In fact the Organization's financial crisis assumed alarming dimensions in the second half of 2005. From August onwards, it had to depend largely on loans from the market. Finally it ended the year with a market borrowing of US\$ 71 million.

46. The reason for the Organization's liquidity crisis under the General Fund is delayed and non-payment of assessed contributions by many members. While short term delays in payment of assessments by members might have caused temporary and limited cash shortfalls, chronic delays in significant payments over the last few years have assumed the form of a serious financial crisis.

47. Despite the crisis, the Organization maintained a 100 per cent budgetary performance. In other words, the appropriations as authorized by the Conference were fully spent in the 2004-2005 biennium. In the PWB 2006-2007 (Document C/2005/3: Summary of PWB), the financial risks to Budget were recognized and it was stated that "in a worse-case scenario, eventual cash deficits in 2006-2007 could lead to curtailment and forced under-delivery of programmes, despite the authority to spend granted through the budgetary Appropriation".

48. Going by the trend that was set in 2004 and 2005, if the uncertainties relating to payment of contributions do not improve on a long term basis, the cash deficit may compel cuts in budgetary performance. However, the Organization has no contingency plan to reduce expenditure depending on priority of the programmes. Neither has it made efforts to identify areas where expenditure can be suspended in the event of serious cash shortage.

49. The Organization emphasized that the Programme of Works and Budget once approved by the Conference becomes an authorization to spend the resources on programme delivery. It stated that the Secretariat cannot unilaterally scale back the approved programmes in a biennium in order to align to receipt of contributions. Further it stated that the majority of Regular Programme expenditure relates to salaries and other committed expenditure and thus the Organization's costs are incompressible in the short term. Moreover, it also assured that the liquidity position is closely monitored through well developed cash forecasts, which are used to predict borrowing needs and to report to the Finance Committee.

50. Borrowing from the open market to deliver Regular Programmes is an unsustainable approach in the long term. Apart from the fact that borrowing cannot be unlimited, regular borrowing also imposes a cost burden on the Organization. While interest charges on loans were US\$ 10,514 in 2004, they grew to US\$ 256,081 till October 2005. In an environment of rising interest rates, such costs will only increase, should the borrowing continue at the same or higher level.

**51. I recommend that the Organization continues to pay close attention to the liquidity crisis so that timely decisions can be taken to regulate delivery of programmes, should the availability of cash fall far short of the requirements. Since a major share of the regular programme expenditure relates to salaries and other committed expenditure like maintenance of office installations, the Organization should make efforts to develop a contingency plan to face the situation. If delivery of Regular Programmes continues to be linked solely to appropriations, it will become unsustainable in a scenario of serious cash crisis.**

52. The Organization is particularly vulnerable to cash shortfalls as it has no reserves or accumulated surplus to tide over delays in receipt of contributions. Last time the Organization received payment of significant arrears was in November 2002, when the major contributor paid an amount of US\$ 92.7 million. Of this, US\$ 44.9 million was allocated - with the approval of the Conference - for one-time expenditures on various programmes including developing IT systems and Corporate Administrative Systems. The opportunity to reduce the General Fund deficit and thus improving the overall financial health of the Organization was thus lost. The Organization stated that it has no plans to consider a similar proposal for the use of arrears in foreseeable future.

**53. I recommend that the Organization should invariably credit any future payment of arrears in contributions solely towards the outstanding arrears so that such arrears are used only to cover past budget expenditures. When received, arrears should not be**

**considered as a new source of Funds but should be used to improve the position of the General Fund.**

#### **Technical Cooperation Programme (TCP) Disbursements**

54. Despite the percentage receipt of current Regular Programme (RP) assessments in 2003 of 88.9 per cent, the lowest in the last five years and the deficit in the General Fund rising, the Organization did not feel any cash crisis till 2003, mainly due to low level of TCP disbursements. Slower disbursements against appropriations and carrying forward of large unspent appropriations to the successive biennium had helped the Organization to manage any liquidity crisis.

55. In the biennium 2004-2005, there was higher TCP expenditure out of the current appropriations. 63 per cent of the appropriations were spent during the biennium itself carrying over 37 per cent of the appropriations in the next biennium. However, in the event payment of members' contributions is delayed resulting in borrowing from the market, disbursement of TCP appropriations need to be linked to receipt of contributions and not budgetary appropriations alone.

56. The Director General in his response to the draft report, confirmed that TCP mechanism is based on a set of criteria approved by the Governing Bodies as well as specific Financial Regulations and member nations expect and encourage full spending of TCP appropriations.

57. While appreciating that Technical Cooperation Programme is indeed extremely popular and many developing nations derive considerable benefit from this programme, the sustainability of such a programme will also depend on the availability of money. In the biennium 2004-2005, while the TCP disbursement has been approximately US\$ 63 million, the Organization had a borrowing of US\$ 71 million from the banks.

**58. I recommend that the Organization considers the issue of aligning disbursement of appropriations of TCP with receipt of contributions in view of the cash crisis and arrears of payment of contributions.**

#### **Long Term Investments and liabilities**

59. The Long Term investment portfolio is earmarked for staff-related liabilities. Comparison of the Long-term investment portfolio with Staff-related liabilities indicated that while the staff-related liabilities increased from US\$ 316.1 million on 31 December 1999 to US\$ 653.8 million on 31 December 2005, the long term assets increased from US\$ 147.65 million on 31 December 1999 to US\$ 208.7 million on 31 December 2005. Thus the gap between staff-related liabilities and long term assets increased from US\$ 168.5 million on 31 December 1999 to US\$ 445.1

million on 31 December 2005. With the current rate of return, long-term assets will be unable to match the liabilities.

### **Long term investments**

#### **Asset allocation**

60. Based on results of the Asset and Liability Study conducted in 2004, the Organization decided to change its asset allocation between equity and fixed income to 50:50. Examination in audit of the asset allocation during the six quarters starting from 3<sup>rd</sup> quarter 2004 to 4<sup>th</sup> quarter 2005 indicated that the above ratio was maintained through a periodic rebalancing initiated by Treasury.

61. As at 30 November 2005, 95.36 per cent of the holdings of the long term bond portfolio were in Euro. The portfolio consisted of 18.34 per cent government bonds and 77 per cent inflation linked bonds. The portfolio had 97.59 per cent of its holdings in instruments with a credit rating of AAA by S&P which was in compliance with the investment guidelines.

#### **Performance**

62. Analysis of the performance of the long term portfolio in 2004 and 2005 indicated that the fixed income portfolio yielded a return of 107 basis points above the benchmark during August - December 2004, while its returns were 15 basis points below the benchmark from January – October 2005.

63. Returns of the long term equity portfolio were 7 basis points above the benchmark in 2004 while they were 88 basis points above the benchmark in 2005. In terms of stock selection and sector allocation, the portfolio was in line with the investment guidelines.

64. Performance of the portfolio and investment managers is monitored by the Treasury Operations Group through quarterly Executive Reporting, monthly portfolio statements from the custodian and from the investment managers. It was observed that there was regular reporting of the performance of the portfolio both by the custodian and the investment managers..

#### **Compliance**

65. Compliance by the custodian and investment managers with FAO investment guidelines is monitored by the Treasury Operations Group through 'Compliance Analyst', a computerised investment monitoring tool provided by the custodian. Triggers were set for the parameters of investment guidelines and any violation of these parameters by the investment manager is reported to the Treasury Operations Group through daily electronic alerts. Examination of a sample of daily compliance reports and action taken by the treasury showed that the system was able to ensure compliance with the investment guidelines.



### **Short-term Investments**

66. Analysis of performance of the short term portfolio during 2004 and 2005 showed that the portfolio performed above the benchmark. It was also seen in audit that the asset allocation of both the short term portfolios was in accordance with the FAO investment guidelines. Performance of the portfolio and investment managers is monitored by the Treasury Operations Group through quarterly Executive Reporting and monthly portfolio statements from the custodian and monthly reports from the investment managers.

### **Performance of Split Assessment**

67. Split Assessment methodology for the assessment of contributions was introduced from the biennium 2004-2005 to reduce the currency risk. Accordingly in the 2004-2005 budget, of the total assessments of US\$ 749.1 million for the Regular Programme, 45 per cent i.e. US\$ 337.1 million was assessed to be paid in US dollar and 55 per cent i.e. US\$ 412 million was assessed to be paid in Euro.

68. From an analysis of the cash positions in Euro and US Dollar in 2004 and 2005 (up to November), it was observed that there had been continuous negative Euro cash balances throughout the period. This occurred primarily because the Organization had no Euro balances at the start of the biennium as it was the first year of the split assessment. In addition, there were further delays in receipt of contributions from member nations.

69. In order to meet the cash deficit in Euro, the Organization has continuously resorted to weekly currency swaps between US Dollar and Euro. Apart from the transaction costs of these swaps, the hidden funding cost is much greater. If the Organization had received Euro contributions in a timely manner, there would have been no need to enter into swap transactions. Hence, there would have been considerably more funds earning interest. It has been estimated that this cost of forgone interest was approximately US\$ 454,000 in 2005 and US\$ 382,000 in 2004.

### **Banking Arrangements**

70. The Organization had in 1998-99 formulated a three-tiered strategy (HQ local banking needs, HQ international banking needs and field office banking needs) to revamp its banking arrangements. Several important issues were considered as part of the three-tiered strategy including rationalization of the number of bank accounts, introduction of Zero Balance Accounts and adoption of electronic banking methods. Currently, the first two tiers involving HQ Italian and international banking platforms are being implemented. Tenders covering this activity were in the final phase of evaluation. Implementation of the third tier involving banking activity in field offices is pending. Important volumes of payments pertaining to FAO HQ are still partly

manual leaving scope for errors and delays. As the banking reform project is in the initial stages of implementation, the Organization has not yet been able to take full advantage of the latest services and technology offered by the Banks.

71. The Organization informed that the steps to implement first two tiers of banking strategy are under way. Full implementation of this strategy is also dependent upon completion of the Human Resource Management System project scheduled for later 2006. It further stated that implementation of the third tier of the strategy is scheduled to commence in late 2007, subject to availability of resources.

**72. I recommend that, as planned, the Organization implements the third tier of the banking strategy and completes the process of rationalization of banking arrangements. The Organization should move towards a regime of total Electronic Data Interchange and e-banking.**

## **REVIEW OF HUMAN RESOURCE MANAGEMENT**

73. A review of selected areas of Human Resource (HR) Management was conducted in audit in December 2005 and January 2006.

### **Introduction**

74. The primary role of the Food and Agriculture Organization is as a Knowledge Organization. Admittedly, the efficient management of Human resources holds the key to ensure effective operation of any Knowledge Organization. Expenditure on human resources remains the most significant part of the Organization's expenditure. Over 84.5 percent of the Organization's Regular Budget is spent on Human Resources. This includes staff (68.4 per cent) and other human resources (16.1 per cent).

75. The Human Resources Management Division (AFH) has the role of developing and facilitating the implementation of human resources policies and programmes and advising management on appropriate strategies to ensure that the Organization is served by competent and motivated staff.

76. To adapt to a changing environment, the Organization has been making efforts to reform and develop appropriate human resource policies, strategies and services. To ensure that it benefits from the full range of Human Resource Services that a modern HR management system can deliver, the Organization has decided to develop a new Human Resource Management Model (HRMM). The HRMM is proposed to be technologically enabled by the new Human Resource Management System (HRMS). HRMM also responds

to the need of business re-engineering in areas of human resource management as necessitated by the development of HRMS.

77. In addition, the latest reform proposals as set out in the PWB 2006-2007 contain wide ranging proposals for streamlining processes, improving human resources management, improving staff motivation, introducing greater flexibility in staffing and increasing levels of delegation to line managers in decentralized offices.

#### **Scope of Audit and Audit approach**

78. The progress relating to development of HRMM and HRMS was examined in audit as combined together, the model and the system will be at the heart of the human resource management of the Organization. In addition, other areas relating to HR deployment, Gender Balance and equitable Geographical Representation were examined in audit. The examination mainly covered the bienniums 2002-2003 and 2004-2005. Wherever relevant, data of earlier periods were referred to in order to analyse important trends.

#### **Human Resource Management Model (HRMM)**

79. To respond to the strategic objectives set out for the Organization of its human resources, the Organization had identified a need to change the way HR services are delivered across the Organization. Also, to derive maximum benefits from the ongoing development of the Oracle Human Resource Management System (HRMS), the HRMS project board identified the requirement of developing a new HRMM. The Human Resource Management Model (HRMM) is a functional framework that incorporates the operational processes, people and technology required to support the provision of Human Resources (HR) services in the Organization.

80. Important components of HRMM are:

- (a) Creation of a centralised HR (Shared Service Centre) for all HR services, administrative matters and transaction processing. This will consist of several service level tiers and delivery channels - Tier 0 (Self Service), Tier 1 (Contact Centre), Tier 2 (Transaction Support) and Tier 3 (Case workers) allowing for the bulk of transactions to be dealt with at one point with more complex issues being escalated for specialist consideration.
- (b) Implementation of a formalized approach to service management and monitoring including the development of Service Level Agreements (SLAs) as a tool for performance measurement.
- (c) Simplified approval chain for each HR transaction (no more than 2 initiators and 2 approvers) and electronic approval routes.

81. The successful operationalization of the full scope of HRMS will be critically dependant on finalization of new HR workflows under HRMM. In terms of the potential impact of HRMM on HRMS business requirements, two key areas are changes in delegation of authority and to the approval process. These will affect workflow design, security design, change management, user communications, procedures, user training and rollout relating to HRMS. The design implications of HRMM for HRMS are also substantial, namely realignment of workflows, incorporation of new reporting requirements and development of a communication portal for HR matters. As per the implementation plan for HRMM, Phase 1 (policy revisions and completion of HR business requirements) and Phase 2 (key process definitions) were to be completed by April 2006. However, progress was slow.

82. The Organization informed that in view of the complexity of the task to manage such a multi layered process and as adequate financial resources were not available, the implementation plan has now been revised with the target date for completion of Phase 1 and 2 being the end of June 2006. It further informed that activities under the HRMM project had started in February 2006 following funding from the capital expenditure facility and Phase 1 and 2 have since been completed. The two projects, namely HRMM and HRMS are now jointly managed in order to monitor the progress and reduce the risks.

**83. In view of the criticality of HRMM to HRMS, I recommend that the Organization continues to pay adequate attention and deploys adequate resources to ensure that no delay takes place in development of HRMM. Any delay will also increase the project cost of HRMS.**

84. The major thrust of the HRMM is consolidation and streamlining of major HR functions as well as extending the coverage of the HR system to include functions either not currently provided or inadequately provided. It envisages integration of various service providers under one delivery centre automated by HRMS. HRMM seeks to achieve improved efficiency in the delivery of transaction processing services through use of self service functionality and the centralization of transaction processing in a Shared Service Centre. This, however, will largely depend on the ability of the HRMS to support the delivery of HR transaction processing at a different geographical location.

85. For the field offices, the success of the self service functionality and the ability to initiate transactions online would depend on the adequacy of Wide Area Network (WAN) connectivity. AFI has developed an estimate of annual ongoing cost for upgrading WAN, varying from US\$ 300,000 to US\$ 750,000. The Oracle Project Management Committee discussion document for HRMS project (May 2005), however, noted that detailed access

requirements needed to size the future WAN do not depend only on the HRMS but the sum of all systems required by a typical field office and that business requirements of field offices may further change as a result of numerous decentralization measures currently in progress.

86. Inadequate WAN infrastructure could thus impair the quality of the connectivity and constrain some of the objectives of the HRMM. At the meeting with Administrative and Finance (AF) Division Directors held in August 2004, the key design concept of self-service was endorsed, but it was commented that though the design could be implemented at Headquarters there may be significant cost implications in extending the concept to the decentralized offices. Considering that the success of the model through HRMS will depend on the connectivity, provision of timely resources is a critical factor for the project.

87. Should the upgrade to the Organization wide WAN not be fully implemented due to its cost implications resulting in the model being implemented only at Headquarters, it would compromise the basic objectives of the new functional framework and various initiatives to decentralize authority and responsibility in the decentralized offices.

88. The Organization assured that a proposal to double the overall bandwidth of the Organization's telecommunication network and to assign this increase to the field offices on an as-needed basis rather than across the board has since been endorsed. The Organization also informed that funding is assured in 2006-2007 and in subsequent biennia.

89. **I recommend that the Organization continues to monitor closely the progress regarding adequate technological infrastructure for the HRMM and HRMS to be successful both at Headquarters and at the field level.**

#### **Human Resource Management System (HRMS)**

90. The rationale behind the HRMS Project is to support the new reform and accountability mechanisms that are to be gradually implemented within the Organization. The specific objectives of the HRMS project are to enable the Organization to manage its human resources more effectively, to align human resource management with Organizational goals and to support the functions required by HR management, planning and monitoring. It also aims at integrating payroll and transaction processing for entitlements into a single corporate ERP system encompassing Oracle Financials, PIREs and all other administrative applications.

91. The HRMS Project since inception has always faced a shortage of resources as estimated project costs always exceeded the available funding. The project envisaged phased implementation based on analysis of gaps between Oracle functionality and the

Organization's business requirements. These gaps were classified as 'Mandatory', "Highly desirable" and "Desirable". Implementation of solutions for all gaps rated as 'Desirable' was left to be considered later during the project. The Organization informed that with the creation of the Capital Expenditure Facility, the Project is now fully funded through the expected go-live date in late 2006.

### **Staffing issues in HRMS Project**

92. Skilled and adequate human resources are critical for successful completion of a project. However, the organization's approach to the staffing of the project has evolved continuously since beginning. Inadequate staffing had caused delays in completion of project activities and extended the initially planned project completion deadline.

93. In the beginning, it was envisaged that the project could be managed only by staff on secondment aided by external resources. This approach proved to be impractical, as only 30 per cent of the staff assigned to the project could be made available due to ongoing work commitments and even external resources were difficult to find. In January 2003, a new staffing policy based on the creation of project posts was approved. However, by January 2004, only 3 staff was on posts against 19 sanctioned.

94. The project has repeatedly faced difficulties in hiring high quality consultants, whose honoraria for this type of specialized technical work are often significantly higher than the rates normally offered by the Organization. The project's response to these difficulties has been ad-hoc waivers of rate ceilings from time to time. In March 2005, it was decided to tender for high level support. Due to the time requirements of international tendering, such resources were not available to the project until December 2005. It was noted in audit that the staff turnover in 2005 has been quite high. 25 individuals joined and/or left the project between January 2005 and September 2005.

95. It is pertinent to note here that as per the project charter, at the beginning of phase 2, an implementing partner was to be selected for the design, configuration, development, testing and implementation of the HRMS system. However, in January 2004, it was decided that such an implementing partner was not required, as the project approach was based on a strong internal project management team that would procure and oversee the work of external resources. This approach was also thought to be relatively inexpensive than those that would have been provided by an implementation partner. It was observed in audit that the project, however, has nevertheless been continuously employing a number of external resources in as much as the project has had contracts with firms such as Accenture, Softlabs and KBACE in addition to Oracle. In fact as of December 2005, 29 out of the 41 persons working on the project were external staff. The original rationale, therefore, of not having

an implementation partner was to some extent invalidated during the life cycle of the project.

96. **I recommend that the staffing issues for the HRMS project be addressed comprehensively and in a consistent manner so that suitable human resource is provided to the project to enable it to complete the remaining phases in time.**

97. The Organization stated that the HRMS Board has addressed the staffing issues related to the project and that it is essentially on track to complete as scheduled. Furthermore, 2006 and 2007 HRMS project activities are now fully funded.

#### **User Communication and Change Management**

98. Absence of a consistent programme for User Communication and Change Management in the project was noted in audit. The project charter stated that user involvement throughout the project is critical to its ultimate success. It envisaged establishment of a Human Resources User Group (HRUG) to guarantee that major issues are not ignored. The HRUG has, however, met on only a few occasions in 2005. The Organization informed that communication with HRUG has now been resumed as the project has progressed.

99. In March 2005, a consultant was identified to perform a review of the User Communication programme but in August 2005, it was agreed that since the impact of HRMM is not very clear, the consultant would prepare only an interim report on change management. The project is now formalizing a formal change management strategy that will start during the second half of 2006 and continue throughout 2007 and 2008 in line with the planned HRMM phased deployment.

100. Involvement of field offices in user communication has been sporadic. Video Conferences with field offices were organized in 2004, but there has been no follow up in 2005. The decentralized Conference Room Pilot (CRP) was cut down so that field office representatives will only attend selected CRP sessions at HQ relevant to their activities and requirements. The decentralized CRP was held only in July 2006 when funding for it was available. This initial focus on Headquarters would require careful management of user acceptance in the decentralized offices. Further, it has to be viewed in the light of increased decentralization proposed in the latest reform proposals.

101. The Organization stated that it is strongly committed to take forward a change management programme involving users at all levels and at all locations. While lack of funding was cited to be a serious project risk, the Organization assured that it will address the issue as a matter of priority as part of both the HRMS and HRMM projects.

102. The Organization further stated that a consultative process with decentralized offices has been put in place now and funds to support this have also been allocated. A communication plan has been developed, communication with HRUGs has been resumed and a four-day workshop has been organized with field representatives.

103. **I recommend that the Organization should establish a comprehensive plan for user involvement - particularly users from decentralized offices so that no occasion arises which would require major and costly changes in the system at a later date. Adequate user involvement and smooth change management is critical for the system.**

#### **User Training in HRMS Development**

104. It was observed in audit that there was reduction in scope and duration of Conference Room Pilot (CRP). The CRP is the first opportunity for users to see how their “to-be” requirements are reflected in the system. During the CRP, gap filling solutions are reviewed and confirmed, change management activities are initiated and users are kept involved. In March 2005, the project board indicated that the number of CRP sessions should be reduced in order to remain within the level of funding available. Subsequently, various options were recommended including reduction of the number of cycles, conducting sessions informally and focusing only on the main functionality and high priority business requirements. As a result, fewer sessions have been run.

105. Initially the User Communication and Training work stream included training for the full user population in HQ, Regional and Country Offices and was initially estimated to cost US\$ 1.23 million. An alternative approach was approved in 2004 in which user training was to be a corporate programme to be provided by Human Resources Development Service (AFHO). The main reason for this was that since this could be covered by the 1.35 per cent staff development allotment, the project cost would be reduced by the same amount.

106. The Organization assured that funds have been made available for HRMS training. The user training programme will start in the 2<sup>nd</sup> half of 2006 and will continue through 2007.

107. **I recommend that in view of its importance, user training for HRMS should be closely monitored.**

#### **Human Resource Deployment**

108. In the past few biennia, the Organization has been cutting costs through efficiency savings. Since staff costs account for the largest part of its budget, downsizing and



decentralisation of the Organizational activities was initiated in a big way. Over the last several biennia, significant changes have taken place in different aspects of HR deployment.

109. From 1996-97 to 2004-2005, there has been a reduction of 891 posts (21 per cent), 96 per cent of which comprised of reductions in General Service posts. The number of professionals and higher decreased from 1487 in 1996-97 to 1449 in 2004-2005, representing a reduction of 2.56 per cent. However, downgrading of professional posts has been significant. Between 1995 and 2004, there has been a 15 per cent decline in the number of P-5 posts. Similarly, there has been a 17 per cent reduction in Director level posts between 1994 and 2005. At the level P1 to P3, however, there has been an increase of 22 per cent during the same period. The Organization stated that this reflected the human resource management strategy to develop a cadre of young professional staff.

110. It is observed that the decline in the number of International professionals during the last decade was far more marked at Headquarters than in the overall Organization. Thus while overall strength fell by only 2.56 per cent, their numbers at Headquarters fell from 1186 in 1996-97 to 1010 in 2004-05 representing a reduction of about 15 per cent. Further reductions in the number of professional posts at the Headquarters are also envisaged in the Reform proposals. The Organization thus faces the risk of lack of adequate support and backstopping to the decentralised offices from Headquarters, should this trend continue.

111. As a result of efficiency savings measures initiated in 1994, 65 International Programme Officers (IPOs) were replaced by National Professional Officers (NPOs) in FAORs offices. This number went up to 106 in 2004-05. Further in the 2006-07 reform proposals, besides strengthening FAORs by placing 45 NPOs posts, 53 NPOs posts are also proposed in Regional / Sub-Regional and Liaison offices. While the decision to use more NPOs is understandable in the context of shrinking resources, the Organization is also deprived of the advantages of using IPOs with international experience and broader outlook.

112. The Organization stated that NPOs are highly-qualified and have been vetted through the Professional Staff Selection Committee. In the national context, they bring an in-depth knowledge of the local culture, administrative/legal practices and the political situation that justifies their use, rather than an internationally-recruited staff member. Budgetary constraint is not the sole reason for deployment of National Professional Officers. The Organization further stated that competency requirements for all personnel have been developed and a management development centre is up and running.

**113. I recommend that the Organization continues its efforts to develop management skills among the personnel. It should also carefully evaluate and define**

**the profiles of its professional staff to ensure that its high level expertise and leadership skills, international character, and ability to support field offices are not weakened.**

#### **Staff Development Activities in Headquarters**

114. Staff Development Activities including Training in Headquarters is an important area in the Organization as it plays an important role in development of its human resources by facilitating the transfer of knowledge and skills to staff members. It was noticed in audit that the staff development activities were overall satisfactory.

#### **Gender Balance**

115. Attainment of the gender balance in all categories of posts especially at senior and policy-making levels, with full respect for the principle of equitable geographical distribution is an important objective in the UN System including FAO.

116. Towards achieving this end, the Organization in 1994, set a goal to bring the proportion of women in Professional categories to 35 per cent. By October 2005, the percentage achieved was 28.6 per cent with only 13.5 per cent at grades D1 and above. While the percentage in women in professional posts in Headquarters is quite encouraging (34.3 per cent), the situation is unsatisfactory in decentralised offices where the percentage of women is only 17.9 per cent. Considering the fact that recruitment in the Organization has slowed down and of late frozen, any dramatic improvement in the gender balance in near future is improbable.

117. With regard to geographical distribution of women employees, as on 31 December 2004, only 32 per cent of Director Level posts are occupied by persons belonging to member states from Africa, Asia, Latin America & Caribbean, Near East and South Pacific. Similarly with regard to Professional Posts occupied by women, only 23 per cent is occupied by persons belonging to member states from Africa, Asia, Latin America & Caribbean, Near East and South Pacific.

118. **I recommend that the Organization should reorient its recruitment strategies to ensure that more women are recruited in the professional posts, especially in the higher positions; while giving due emphasis to developing nations where the representation levels are even lower.**

119. The Organization stated that at present it is going through downsizing and freeze on recruitment. However, despite that it is seeking on an on going basis to recruit more women while redressing geographical imbalance and at the same time ensuring that highest standards of competency are applied.

## **AUDIT OF DECENTRALIZED OFFICES**

120. During the biennium, external audit teams visited two regional offices at Ghana and Santiago and 9 country offices. Four of these were in Africa, two in Latin America and three in Asia. The audit included examination of the accounting records and supporting documents, systems and procedures, Field Accounting System (FAS), decentralization of operational responsibilities, procurements and inventory. Selected TCP and Trust Fund projects were also reviewed.

121. As far as compliance with the Organization's rules and regulations in day to day operations of these offices are concerned, no serious irregularity was noticed. Stray cases pointed out during audit in these offices have been addressed or in the process of being addressed.

### **Project management in Decentralized offices**

122. It was noted in audit that gaps of several months between the approval of projects and actual commencement on the ground were not uncommon in many of the offices. Factors like delay in signing of documents by the host governments, delay in recruitment of the suitable personnel, changes in host departments etc. contributed to the overall delay in start up of the projects.

123. Significant delay was also noticed in formal operational and financial closures of the project, even after all the activities related to the projects had been completed. Non submission of terminal reports as also non adjustment of final charges were two main reasons for such delay. The Organization expected that introduction of automatic triggers in Field Programme Management Information Systems (FPMIS) and related monitoring by Headquarters and Field staff would improve the situation.

124. Serious financial irregularities were however, noticed in FAOR Nigeria in the management of National Special Programme for Food Security in Nigeria. These irregularities included cash advances paid to staff members lying unadjusted beyond the prescribed period- in some cases more than two years, disbursement vouchers not properly prepared, proper procurement files not being available, cheques cancelled not being adjusted in the accounts. It was also noted in audit that even though such an important project is being implemented in the country, the post of FAOR remained vacant for long periods. Absence of FAOR who is also the budget holder contributed to the difficulties experienced by the Organization in the local management of the project at the ground level as reflected in the irregularities.

125. The Organization in reply informed that a comprehensive review has been initiated and as a result, a new control structure including a dedicated project Management Support Unit (MSU) had been approved for establishment under the successor phase 2006-2010. It further

informed that a working group has been set up to review the Nigeria SPFS programme. A resident internal auditor is also being recruited to improve controls.

**126. In view of the seriousness of the irregularities in the SPFS project in FAOR Nigeria, I recommend that the Organization should establish a time bound programme to set right, to the extent possible, the irregularities that already have taken place. It should also consider inclusion of internal control mechanisms at the time of project formulation of such high value projects in future and all such internal control mechanisms should be functional from the beginning of the projects.**

127 On this recommendation, the Organization has informed that action to ensure adequate internal control in future high value projects including but not limited to the presence of an internationally appointed internal auditor has been approved by the Director General.

### **PART III**

#### **OFFICIAL TRAVEL**

##### **Introduction**

128. Travel in Food and Agriculture Organization (FAO) is one of the critical inputs for the implementation of the Organization's programmes and policies. The aggregate expenditure incurred on travel in the biennium 2002-2003 was US\$ 138.5 million, which constituted 9.89 per cent of the total expenditure of the Organization. Travel can broadly be categorized as duty travel by staff and consultants, travel by non-staff members and entitlement travel of staff members. The total number of travel authorizations generated from January 2002 to October 2004 was 49,617 out of which 38,800 were duty travel.

129. The Travel unit of the Organization functions directly under the Chief, Management Support Service, AFDS. The Travel Unit was transferred to AFDS in January 2004. The Head of Travel unit is assisted by three groups namely (i) Travel operation (ii) Systems and (iii) Shipping & Insurance.

##### **Scope of Audit and Audit approach**

130. During the audit, travel authorisations during the biennium 2002-2003 and year 2004 up to October 2004 were covered. The primary objective of audit was to examine the policies, systems and procedures of the Organization with regard to travel. The scope for savings as well as for improvement in the procedures in force at present was also examined taking into account the efforts of the Organization to achieve process oriented efficiency savings by reducing costs of

input without any negative material impact on the outputs. Examination in audit included, in addition, overall control environment and compliance with the existing provisions in the manual.

131. Audit procedures included use of questionnaires, interviews and discussions, examination of files and related records in the travel unit and other departments in the headquarters, and review of IT based information available in the travel unit, Information Systems and Technology Division (AFI) and Finance Division (AFF). The sample size of travel authorizations was chosen on random basis and these were checked on various attributes like class of travel, delay in processing, routing etc.

### **Revenue sharing arrangements for Travel Services**

132. At present, the travel services such as air ticketing are managed by a concessionaire who has been engaged by the Organization to provide “all necessary services as required for the travel of the staff of the Organization and of all such persons as the Organization may approve.” The Organization has also taken a few economy measures in matters of air travel which include fixing the class of accommodation for air travel for all cadres, use of non-endorsable tickets and adoption of the direct economy route with least cost airfare.

133. At the heart of this arrangement with the concessionaire is the “revenue sharing model” in which the latter is required to transfer the commission earned by him from the airlines; the Organization is to pay to the concessionaire a management fee of 4.5 per cent of the value of the tickets including all taxes (less commission provided by the airlines). The Organization is also required to provide office space, furniture, electricity and stationery including the maintenance charges.

134. Such a revenue sharing model requiring payment of management fee at a percentage of the value of the tickets creates an intrinsic conflict with the economy measures in as much as the income of the concessionaire is directly dependent on the volume and value of the air tickets. The concessionaire is also the sole deciding authority as to what is the least cost route on a particular day which in turn leads to reduction of his income.

135. The Guild of European Business Travel Agents commissioned in 2000 a Scheduled Air Products Study by Deloitte Consulting. It was noted there that all the airlines provided other remunerations to travel agents, in addition to the basic commission. These remunerations, which often are not published and are results of bilateral service level arrangements, are all volume centric and growth oriented. The revenue sharing model followed by the Organization does not take into account the additional remuneration normally earned by the travel agents.

136. The model overlooks the fact that such an arrangement exposes the Organization to the risks associated with increase in the fare or tax, whereas the concessionaire stands to gain in case

of any increase. While the management fee of 4.5 per cent has remained constant, the commission to be passed on to the Organization has come down drastically. When the Organization signed the contract in 1996, the commission provided by the airlines was in the region of 7 per cent and hence passing on a management fee of 4.5 per cent was still favourable for the Organization. During 2004, the airlines reduced the overall commission to 1 per cent, thus putting an additional cost to the Organization for each ticket.

137. In 2003, for example, with a commission of 7 per cent, the savings of the Organization were to the extent of 2.8 per cent of the cost of the tickets. In 2004, when the commission dropped to 1 per cent, the Organization had an added cost to the extent of 3.5 per cent of the value of the tickets.

138. The Organization, having recognized that the travel industry had evolved significantly since the last tender and the conditions then in force in the area of airline commissions are no longer attainable, decided to re-tender the contract. An inter-departmental group set up for the purpose had taken these aspects into consideration. It further informed that the fresh tender being floated, is based on a transaction fee model rather than on a revenue sharing model.

139. **I recommend that the Organization concludes the tender process and finalises the contract as soon as possible to avoid incurring additional costs that it has been burdened with.**

#### **Impact of the Economy measures**

140. It was noted from an analysis of data that the intended objectives of several economy measures taken by the Organization are yet to be achieved. As per the manual section 401.3.32 and the travel economy circular dated 22 January 1996, the entitled class for travellers at D-2 level and below is the class immediately below the first class when the duration of a flight exceeds 9 hours. For flights of 9 hours duration or less, transportation shall be by the economy class. Only non-endorsable air fares are authorized by the Organization. The Medical Directors of the United Nations Systems had recommended that for health reasons, all travel of five hours and more should be in business class. It is recognized that FAO is one of the more economically-oriented UN agencies in the area of business class travel, applying a policy of business class travel entitlement when the journey time exceeds nine hours. But achieving economy with such a practice, which is undocumented, will depend largely on monitoring of air routes and also waiting hours at the connecting airports.

141. The business class expenditure is twice the expenditure on economy class expenditure, as shown below:

(in €)

2002		2003		2004 (up to October)	
Business	Economy	Business	Economy	Business	Economy
8,423,767	4,165,628	8,635,337	4,100,311	6,070,999	1,891,502

142. An examination of Travel Expense Claims (TECs) of the sample indicated several cases of travellers travelling by business class as the waiting time at the connecting airports added to the actual flight time exceeded 9 hours. The Organization does not have any mechanism to ensure that the air routes provided by the concessionaire are indeed the most direct and economic ones.

143. The Organization stated that it is their long standing practice to define flight time as being the time of scheduled departure from the official station to the time of arrival at the next duty stopover.

144. **I recommend that the manual section be revised to clarify the specific definition of journey time. I also recommend that Organization should develop mechanisms to check, at least on a sample basis, the application of the Organization's rules.**

#### **Prepaid Ticket Advices**

145. Prepaid ticket advices (PTAs) instruct the concessionaire to purchase tickets on behalf of travellers originating travel outside ROME. This is a significantly expensive travel arrangement for the Organization. In terms of value, the PTAs constituted 35.28 per cent and 33.44 per cent of the total value of the tickets in two years as shown below:

	Amount ( € )	
	2002	2003
Total Tickets issued	11,805,926	12,258,882
PTA	4,165,628	4,100,311
PTA to total Tickets	35.28 per cent	33.44 per cent

146. The cost of PTAs is high as they involve travel originating outside Rome, for which the travel agent does not obtain the normal discounts from full fares. In addition to the higher fares, the airline issuing the ticket charges an additional amount which is passed on to the Organization.

147. The Organization noted that the use of prepaid ticket has decreased significantly in 2003 and 2004 demonstrating that the Organization is already using other methods of purchase of tickets. The Organization also noted that PTAs were generally being issued either for countries where FAO or UNDP does not have an office (such as Europe, Japan and Australia) or for flights to/from Africa, where the travel agent in Rome is better able to book tickets because of stronger currency and greater availability of computer systems in Rome.

148. **I recommend that the Organization continues its efforts to bring down the number of Prepaid Ticket Advices in the interest of economy.**

**Lump Sum payment for home leave and appointment, transfer & repatriation etc.**

149. The Organization had introduced, on an optional basis, a system of lump-sum payment in parallel with the normal travel arrangements for home-leave, family visit and education grant travel with effect from 1 June 1990. The lump-sum payment was intended to be in lieu of all travel expenses and amounts to 80 per cent of the full air fare to the airport nearest to the staff member's destination for home leave to which the staff member would have been entitled under FAO travel rules. On completion of travel, the staff members were required to submit a Travel Declaration within 90 days of the completion of the travel, (i) certifying that travel had been undertaken and that (ii) a minimum of seven days had been spent in the home country and (iii) indicating the name of the family members travelling, the travel dates and the itinerary of travel.

150. Expenditure on entitlement travel amounted to US\$ 16.89 million in 2000-2001 and US\$ 18.15 million in 2002-2003. A review of a few Travel Expense Claims (TECs) indicated that in many cases, the staff members have been able to save significant amount by travelling on cheaper air fare. When the procedures were introduced in 1990, benefits of cheap air fare were not widely available and the Organization even for duty travel was issuing fully paid fare. Even though the Organization now uses only non-endorsable fare for duty travel, the lump sum advances are given on fully paid fare.

151. Such lump sum payments were recorded as staff member advances and upon receipt of certification of the travel, a TEC was raised to clear the advance. With effect from 1 February 2004, primarily to effect economy in raising and processing the TECs, the advances were expensed immediately and the certification was watched through e-travel system. It was noted in audit that an amount of US\$ 182,136.01 was outstanding against 60 staff members for the period prior to 1 February 2004. Similarly, for the period from 1 February 2004, an amount of US\$ 350,087 was yet to be certified (as on 1 October 2004) against 124 staff members; of these, 35 cases for an amount of US\$ 92,385 were outstanding for more than 180 days. The Organization has not done any risk assessment from the point of view of internal control environment, while introducing such measures. Two cases of fraud involving false certification have already



surfaced. The administrative savings arising out of non-submission of any claim relating to such journeys also need to be balanced with costs to watch adjustment of advances and the risks to the control environment.

152. The Organization replied that it has begun actively soliciting staff certifications since the latter part of 2004 and recovery of outstanding lump sum advances on a monthly basis commenced in February 2005.

153. As regards internal control, the Organization informed that Internal Audit (AUD) has envisaged checking documentations on a sample basis relating to such travels as part of their regular audit plan. The effectiveness of the procedures as also risks to the internal control will be reviewed after AUD review.

**154. I recommend that the Organization continues its efforts for staff certification of travel within the prescribed period. I also recommend that AUD should conduct the first review of the lump sum payments and the documentations early, so that the Organization can evaluate the effectiveness of the procedures and risks, if any, such procedures pose to the control environment.**

#### **Review of ATLAS**

155. ATLAS- a software package- was introduced in May 1999 to provide travel accounting and information functions in the Organization. The software was developed by a private company for use in the International Atomic Energy Agency and then later was customized for the various UN Organizations using it. The initial cost to the Organization for system development was US\$ 250,000. Apart from the initial development cost an amount of US\$ 80,000 has been incurred for customisation, US\$ 24,380 for special consultancy and US\$ 196,000 for maintenance costs till the date of audit.

156. As per the system proposal the ATLAS system was to provide process automation, on line travel information, unified control of travel throughout the Organization, enhanced reporting capabilities, increased productivity of travel administrators and improved quality of travel related data. It was also envisaged that the benefits will greatly outweigh the costs.

157. The software package is a proprietary one owned by the company which developed it, even though it was primarily developed for IAEA and FAO. Even though an analysis of system suitability for the Organization was conducted and a detailed system proposal prepared by the company was accepted by the Organization, it was observed that from the time of initial implementation till October 2004 a total of 725 "System Change Requests"- mostly requests for improvement- have been raised. Out of these, 676 have been closed, 37 require client action and 12 require action by the company to satisfy new requirements.

158. It was noted that the current version of ATLAS in production is Version 2.5.0. The version 2.6.0 and version 2.7.4 which superseded version 2.6.0 have been received as part of the annual maintenance support and user testing is in progress. Though there was a plan to replace the ATLAS travel system in 2001 and the project was expected to be funded by the arrears kept by the Organization for development of various systems, the plan was postponed indefinitely.

**(a) Enforcement of travel policies**

159. It was envisaged that ATLAS system will enforce support for travel policies of the Organization. Use of standard Organization codes, project codes, travel types, ticket classes, mode of travel etc. was to be enforced by the system. For several reasons, however, the system is not able to enforce any of the travel policies. The Organization's policies prescribe the entitled class of travel on the basis of the grade of the traveller and duration of the flight. The database, however, does not capture the actual time of the start and end of journey. Thus it is not possible to calculate the duration of the flight which determines the entitlement for class of travel to be used. It also does not capture any information about the class of travel actually used. It does not perform any check on the grade of the traveller.

160. A review of ATLAS system revealed that Atlas contains the tables for storing distance between two locations and the airfares. However they are not practical to determine the travel entitlements. In fact, these tables have been removed from ATLAS in release 2.6.0 which is currently being tested for FAO implementation.

161. In the absence of this information it is not possible to determine whether the traveller has travelled as per the policies of the Organization. ATLAS does capture the fare quote provided by the travel agent, but does not indicate whether the cost of ticket includes the cost of private journey performed along with the official journey. In the present system the travel unit has to rely completely on the travel agent for enforcement of these policies.

**(b) Linkages with the travel agencies**

162. It was envisaged that ATLAS will have tight linking with travel agencies. However, ATLAS can interact only with one Travel Agent. There are, at present, different travel agents for headquarters and each of the regional offices. As of now, the travel agent at Headquarters is only integrated with Atlas. The travellers at the regional offices have to get the quotation off line from their local travel agent and feed the airfare in the plan section of the Travel Authorisation. The system is also not able to capture any change in the airfare or any cancellation of the tickets for the travels originating at the field or the regional offices.

(c) **Lack of validation checks in ATLAS**

163. In any computerised system the existence of validation checks eliminates the possibility of human errors, ensuring data integrity. It was observed that ATLAS system was deficient on this front. The validation checks on the date fields do not exist. In a number of Travel Authorizations it was observed that the date of end of trip was earlier than the date of start of journey which makes any analysis on date fields meaningless. In fact on several counts, the data in ATLAS was not dependable. Many of the functions which could have been automated, such as calculation of DSA based on the start and end of the journey, continue to be performed manually.

164. The present version of ATLAS is not web based and hence will prove to be of significant impediment to decentralization of travel authorization and travel processing.

165. Thus, as a package, ATLAS is not quite adequate for any complete travel processing and monitoring. The drawbacks mentioned in the preceding paragraphs will prove to be significant impediments to future decentralization of travel claims processing and monitoring. Any decentralization of air ticketing through which the Organization can achieve significant cost savings will also be impeded by the above mentioned drawbacks of ATLAS.

166. The Organization stated in its reply that replacement of travel system has been included in the Capital Expenditure Plan, which will be presented to the Conference in November 2005. Once approved, and subject to the availability of funds to cover both external purchase/development and internal support/ staffing costs, the replacement could be expected to take place during 2006-2007 biennium and will provide the Organization with opportunities to address various shortfalls identified and satisfy current as well as future business needs.

167. **I recommend that the Organization continues with the process for replacement of the travel system in order that it fully meets the current and future requirements of the Organization. I also recommend that adequate resources may be provided for having a web based travel monitoring package fully integrated with Oracle Financial Applications.**

**Other Expenses in TA**

168. As per staff rule 302.7.551, necessary miscellaneous expenses incurred by a staff member in connection with the transaction of official business or in the performance of authorized travel are reimbursable by the Organization after completion of the travel. It was noted during audit that "Other Expenses" claimed in the TECs varied from US\$ 0.05 to US\$ 30,000. Such expenditure included items like Ad hoc DSA, Air Ticket, Excess baggage, Hazard Pay, honorarium for special Delegates, Visiting Expenses, Interpreter and Hospitality. Honorarium given to Special Delegates

was also booked under this head. In some cases, air ticket charges were also booked under this head.

169. Some of these expenses do not relate to travel but were booked under this heads. This inflates the expenditure booked under travel expenses. Ideally these should have been booked under respective budget heads in the relevant programs.

170. The Organization agreed that this was an area that required to be addressed. It stated that the expenses that can be categorized as "Other Expenses" have now been categorized and steps have been taken to amend the travel expenses list configured in ATLAS. Once the configuration is updated, guidelines will be issued to the users.

**171. I recommend that the task of configuring the travel expense list may be completed as early as possible and suitable guidelines issued.**

## **REVIEW OF CONTRACTS FOR LOCAL SERVICES**

### **Introduction**

172. Procurement of Goods and Services is one of the important activities of the Organization. It is governed by the procedures established in Section 502 of the Food and Agriculture Organization (FAO) Manual. The principal objective of the procurement activity is timely acquisition of goods, works and services in a competitive and transparent manner to ensure the effective and efficient use of resources.

173. Procurement Services (AFSP) in Headquarters is mainly responsible for providing procurement services through contracts, once a service is requisitioned for by the concerned divisions or departments. Printing contracts, however, are the responsibility of the Information Division of the General Affairs and Information Department.

174. During the biennium 2002-2003, expenditure on such contracts was approximately 9.8 per cent (US\$ 137.6 million) of the expenditure of the Organization (US\$ 1399.8 million). From January 2003 till August 2004, approximately US\$ 127 million was committed through 161 contracts. In addition, approximately US\$ 4.7 million was spent on printing activities from January 2003 to November 2004 through 1722 contracts.

175. The contracts entered into by AFSP and examined in audit could be classified into two categories. The first category was in the nature of Works contracts, i.e. one-time contracts for specific works or services. The second category was for on-going contracts providing continuous services such as maintenance of facilities, courier and re-mailing services, etc. The second category of contracts, in most cases, amounted to outsourcing by the Organization.

### **Scope of Audit and Audit approach**

176. The primary objective of audit was to examine the policies, systems and procedures of the Organization with regard to contracts. Scope for savings as well as improvement to existing procedures was also examined. The existing efforts of the Organization to achieve process-oriented efficiency savings by reducing costs of input without any negative impact on the outputs were taken into account while conducting the audit. In addition, examination in audit included overall control environment and compliance with the existing provisions in the Manual.

177. Audit examination was based on a sample of contracts entered into by the Organization in Headquarters from January 2003 to August 2004. For AFSP, a sample of 39 contracts was chosen based on stratification on monetary value of these contracts. For Printing contracts, a random sample was chosen.

### **Outsourcing by the Organization**

178. Outsourcing is contracting with a third party to provide non-core activities and services (including related goods where applicable), which activities and services have been or could be otherwise provided by Organization's staff. Going by the above definition, for the past few years the Organization has outsourced many activities. Such activities include maintenance of buildings, gardening and transport services, electrical maintenance work, booking of airline tickets, maintenance of hardware and other IT facilities and even system development activities. Outsourcing has been recognized as one of the important strategies to achieve cost savings for the Organization. In the progress report on efficiency savings submitted to the Finance Committee, possibilities for further outsourcing have been recognized.

179. It was noted in audit that the Organization is yet to adopt an overall strategic policy on outsourcing. The limited concern of the Organization appeared to be efficiency savings and outsourcing generally has been considered by the Organization from that point of view. Several other issues such as impact on costs, quality measurement indicators to assess delivery of service, impact on staff, number of service providers to provide service both at Headquarters and in the field in the light of decentralization of the Organization, remain unaddressed to a large extent.

180. The Organization noted that policy guidance has already been given by the Finance Committee- in particular by the Finance Committee in its 89<sup>th</sup> session in May 1998 - while they reviewed the Joint Inspection Report (JIU/REP/97/5) on "The challenges of outsourcing for the United Nations System". The Joint Inspection Unit (JIU) had indeed recommended a policy statement but the Finance Committee had noted that outsourcing was an established practice within the Organization and the recommendations had either already been implemented or were not relevant to the Organization in the light of experience in this area.

181. Since then, considerable expansion has taken place in the outsourced operations of the Organization. Significant decentralization of activities of the Organization has also taken place. Besides, the United Nations General Assembly, in December 2000, has adopted a resolution (55/232) guiding outsourcing practices in the United Nations. Periodic reports are being submitted to the General Assembly by the Secretary-General on the progress achieved in the implementation of the above mentioned resolution. Similar directions were found to be absent in the Organization.

**182. I recommend that, in view of the changed circumstances, the Organization develops comprehensive policy/guidelines covering issues such as impact on costs, impact on staff, quality measurement indicators and decentralization of services for approval at the appropriate level, including if required, from the Governing Bodies, to govern its outsourcing operations both in Headquarters and in the decentralized offices.**

#### **Factoring Costs in the tendering procedures**

183. Until now, the Organization has achieved outsourcing through the contracting process in accordance with provisions of the Manual. Section 502.6.32 of the Manual, which largely governs the tendering procedures for such contracts, provides for awarding contracts to bidders submitting the best technical proposals subject to the availability of budget for that particular activity. In some cases, ad hoc criterion such as tolerance of 25 per cent difference between the best technical offer and the second best was adopted.

184. It was noted in audit that the existing provisions in the Procurement Manual allow placement of the contract on the best technical offer without considering costs. This process involves invitation of bids - in most cases in a two-bid system, evaluation of these on technical parameters and then awarding the contract to a firm with the best technical offer.

185. During audit, it was seen that in many cases, while technical evaluation of the bidders did not highlight significant differences, the financial proposals did. However, since the best technical proposal was awarded the contract without taking into account the differences in the financial bids, the Organization lost significant opportunities for cost savings.

186. Audit examination of the contracts related to Information Technology, in particular, noted that in some cases the difference between the best and the second best technical offer was small but the cost differences were significant. These contracts related to deployment of personnel to perform various system-related tasks in the Organization and specified the rates for each category of personnel, together with the names of personnel. For individual deployment of personnel for specific assignment of work, work orders were issued by Information Systems and Technology Division as and when necessary. Such contracts were issued after technical

evaluation and, following practices of the Organization, generally the firm with the best technical offer was issued the contract.

187. The Organization agreed that it would consider amending the Manual to include cost as a parameter in the tendering process in order to achieve savings. It informed that the matter has been put on the agenda of the Procurement Working Group which has been tasked with the review of Manual provisions on procurement.

**188. I recommend that the Organization should amend provisions in the Manual to include costs as an important factor for award of any contract. Technical parameters and costs should have a balanced weightage to ensure value for money for the Organization.**

### **Evaluations of Bids**

189. The United Nations' guidelines for initiating outsourcing steps require programme managers to review alternative steps, perform cost benefit analysis, prepare preliminary cost estimates, draw up an adequate list of vendors, if necessary, through advertisements, determine quality criteria and assess various risk factors. While these guidelines are not automatically applicable to the Organization, they represent good practice for outsourcing. It was noted that except in the case of a contract for removal of household goods, where an expert was appointed as a consultant to study in detail the market conditions, develop desirable technical parameters for the contracts and bid evaluation methodology, the Organization did not undertake any such exercise in respect of any other contract.

190. The manual provisions governing the outsourcing operations in the Organization also do not envisage any of these steps. Determining quality criteria for evaluating the bids is of utmost importance to the Organization as according to the existing provisions in the manual, technical evaluation has an in-built edge over financial bids. The technical evaluation and more importantly, determination of the technical parameters for such evaluation, become key factors for the evaluation of bids.

191. Examination of cases in audit indicated that the technical parameters based on which the bids were evaluated differed widely in scope, content and methodology. In the case of a contract for removal of household goods, etc., elaborate technical parameters with a points system for each of the parameters (totalling 500 points) were worked out. These points were divided under various headings such as Corporate profile, Administration, Operations, etc., with underlying parameters for each. In contrast, for contracts relating to provision of services relating to computers, three broad parameters –(totalling 100 points) - such as “the firm’s general experience in the field of required contract service” (20 points), “specific experience and track record” (30 points) and “personnel to be deputed” (50 points) were considered. Yet in another case of a

contract for cleaning of the building, portering, etc., the system of priced bid was followed with a few mandatory criteria on a pass/fail basis.

192. The Organization stated that though the manual provision does not itself provide a minimum set of guidelines, the Unit concerned provides a framework for use during the course of technical evaluation of proposals including a point structure based on general and specific experience of the firm, the proposed methodology for the works requested and the qualifications of personnel. These guidelines can be adjusted as required to meet specific technical needs. The criteria for the technical evaluation of a proposal are also approved by the Director Administrative Services division or the Procurement Committee depending on the value of the contract.

**193. I recommend that the Organization develop and document principles determining requirements of technical proposals or otherwise. A minimum set of parameters for technical evaluation taking into account the good practices of other international organizations should also be developed and documented. Additional guidelines as necessitated by complexity of specific contracts should be supplementary.**

#### **Inadequacy of vendor response**

194. The provision in the Manual states that the principal objective of procurement activities is acquisition of goods, works and services in a competitive and transparent manner. One of the important ways to ensure competition is to widen the vendor database and to ensure that for any invitation for bids, maximum number of vendors responds.

195. Analysis in audit revealed that vendor response in many cases ranged from 20 to 30 per cent. In one extreme case, bids received were as low as 6 per cent of the bids invited. In terms of numbers, in most cases the Organization had to choose from among 3 to 4 bids even though a considerable number of bids were invited.

196. In some cases, after receipt of bids, several were not considered as the bidders were not found up to the standard expected by the Organization. In one case of 12 vendors submitting bids, seven were excluded from consideration, six of which on the grounds that they did not have clients with similar premises and services as those of the Organization. Invitations to such bidders could have been avoided in the first place, thus avoiding wasted correspondence and staff time. This also indicated inadequacy of the information on the vendors.

197. Considering that the Organization does not resort to open invitation through newspapers or websites, nor does it participate in instruments such as United Nations Global Marketplace portal, expanding the vendor base is of utmost importance to the Organization to retain competition and transparency.



198. The Organization in its reply asserted that given the logistical difficulties often associated with the procurement activities of the Organization, the response rate of 20-30 per cent is considered by it as not only satisfactory but good. However, it stated that significant efforts are under way to strengthen the vendors' database including updating information on current registrations, pre-qualification of new registrants and pro-active efforts to reach out to geographic areas.

**199. I recommend that the Organization should continue its efforts towards strengthening the vendors' database to increase response to its invitations for bids.**

#### **Management of Works contract**

200. One way to achieve value for money for a Works contract is to determine correctly the variables that would determine the price and performance of the contract. In other words, this would mean determining the specifications as precisely as possible, anticipate the variations and structure the contract conditions in such a manner that the Organization would have reasonably adequate safeguards against loss, even if specifications change at a later date, once the work is started.

201. Procurement Service (AFSP) receives the requisition from the operational department or offices and normally enters into a fixed price contract. Several cases were noticed where the actual work was less than that envisaged in the contract, but the Organization failed to take advantage because of the fixed structure of conditions in the contract.

202. The Director, Library and Documentation Services (GIL), issued a requisition for movement of books of 16,000 linear metres to various locations in Rome and return to the library when renovation of the library was completed. A contract was entered into for an amount of € 221,041. However, before the work started, the volume of books to be moved came down to 14,050 linear metres due to weeding, but the Organization could not gain any advantage from this reduction. On the contrary, it had to pay an extra amount of approximately €29,000 because of non-readiness of the location on the starting date indicated in the contract and requirement of a different route for return of the books.

203. In October 2003, AFSP entered into a transportation contract to deliver goods from Gaziantep, Turkey to Baghdad. In view of the increased risks to the drivers on this route, the rates were in fact increased after the contract was signed. It was in the nature of a fixed price contract. The Ministry of Agriculture later changed the delivery point to Mosul which was significantly closer to the Turkish border than Baghdad. However, the Organization did not benefit from such shorter distance because of the fixed price of the contract.

204. In a Trust Fund project, in a contract for construction of a Soil Laboratory in Eritrea, the contractor was required to be paid in local currency as per conditions in the contract. The contractor subsequently requested payment in US Dollars citing preferential exchange rates. He also assured not to ask for any escalation of costs. The Organization agreed to the condition, giving the contractor a gain of approximately 40 per cent. The Bank Guarantee given by the Contractor at the beginning continued to be held in the local currency. The contractor's assurance of not asking for escalation was also not converted into an amendment of the contract. In short, the risks to the Organization continued at the same level, but the Organization did not reap the benefit of the preferential exchange rate which passed on to the Contractor.

**205. I recommend that the Organization should impress upon the requisitioning divisions to draw up specifications with greater care.**

### **Implementation and Management of Contracts**

206. The Organization had entered into many service level contracts, where the contractors are required to maintain or provide designated services on an ongoing basis. These contracts provided for conditions in the form of penalties or liquidated damages which were to be levied in the event of non- performance of the contractor according to the quality and timeliness of delivery envisaged in the contracts. A review by audit indicated that while the conditions included in the contracts were comprehensive, these were not always enforced uniformly.

207. While recognizing that non-enforcement of certain clauses can be seen as making procurement process less transparent, the Organization noted that the contract must be considered as a whole including all relevant factors such as costs and resources, when deciding to enforce a contract clause. It also stated that the fact that the penalty clauses may not be enforced fully may not be sufficient justification for not entering them into the contract.

**208. Appreciating that checking each supporting document together with invoices may be a costly affair involving additional staff, I recommend that on a random sample basis, periodical monitoring should be conducted with a view to ensuring that performance of the contract adheres to the conditions therein.**

### **Printing Contracts**

209. The printing contracts were examined on the basis of a random sample. We noted that most of the external printing jobs are undertaken on an urgent basis. As per Manual Section 705.331, for procurement of printing, tenders could be waived for reasons specified therein and section 705.332 specifies authority to waive tenders for the monetary limit specified. In the printing contracts reviewed, it was observed that while waivers of tender formalities was

common, such cases had not been regulated as per provisions of the Manual, since approval of designated authority was not found to have been obtained.

210. The Organization agreed that a signed statement of justification would be placed on file.

211. **I recommend that all cases of waivers of tendering procedures in printing contracts should be regularized without delay and in future, such waivers should be approved by the designated committee.**

### **Escalation**

212. In a good number of printing contracts, extra payments had to be made due to changes made to text/graphics and other printing features, which were made subsequent to entering into the contract. Such variations were due to the fact that changes were made before the final files went to the printer; originators often making last-minute changes to printing jobs, thereby incurring extra costs.

213. **I recommend that the Organization make special efforts to ensure that the originating divisions are aware of the cost implications for last minute-changes after materials are handed over to the printer.**

## **PART IV**

### **OTHER MATTERS**

#### **Write-Offs**

214. Financial Regulation 10.4 authorizes the Director-General the writing off of losses of cash, supplies and equipment and other assets, other than arrears of contributions. A statement of such losses written off during the financial period is required to be submitted to the External Auditor with the final accounts.

215. During the biennium there were three cases of write-offs. A Consultant received an operational cash advance of approximately US\$ 13800 of which US\$ 980 was stolen from his hotel room. The amount was written off in September 2004. Cash amounting to US\$ 443 stolen from a project office was written off in July 2004. An amount of US\$ 74,980 representing falsified cheques dating back to 1998 was written off in November 2004. It was noted in audit that these write offs were done after proper inquiry.

216. During the biennium, the Director-General granted ex-gratia payment of US\$ 38,664 to the family of a staff member who was reported missing. The amount represented the equivalent of the death grant that would have been paid to eligible member of his family in the event of death of staff member. The ex-gratia payment was granted upon written acceptance by the spouse that

regardless of the future developments in the case, no further separation indemnity would be authorized and paid. Another amount of US\$ 5000 was granted to the widow of a project staff.

#### **Cases of Fraud or Presumptive Fraud**


217. In pursuance of item 6 (c) (i) of the Additional Terms of Reference governing External Audit, the Organization provided a list of 9 cases of fraud and presumptive fraud involving an amount of US\$ 42519 known to the Organization for the biennium 2004-2005 and information regarding follow-up of previously reported cases.

218. It was noted that 3 of these 9 cases involved submission of false claims to the Organization's After Service Medical Coverage Plan by former staff members or their dependant relation. All have been removed from the Plan. 2 cases involved submission of false documents relating to entitlement travel and education grant. In both cases, the amount has been recovered. In one case the staff member has resigned and in the other, the staff member has been dismissed from service. 3 cases involved falsification of documents to generate duplicate payment and embezzlement. In two cases the concerned staff members were dismissed and in the third - a personal services agreement subscribed - was debarred from future employment. In the remaining case, a staff member on secondment to United Nations committed financial irregularities and was dismissed from service for misconduct.

219. I am of the opinion that appropriate action and sanctions were taken, where applicable, in these cases.

#### **Acknowledgement**

220. I wish to record our appreciation of the cooperation and assistance extended by the Director-General, his officers and staff during the audit.



**(Vijayendra N Kaul)**  
**Comptroller and Auditor General of India**