



INTERNAL AUDIT DIVISION

REPORT 2020/062

Audit of programme support costs at the United Nations Human Settlements Programme

**Internal controls relating to management of
programme support costs need to be
strengthened to enhance transparency and
effectiveness**

29 December 2020

Assignment No. AA2020-250-02

Audit of programme support costs at the United Nations Human Settlements Programme

EXECUTIVE SUMMARY

The Office of Internal Oversight Services (OIOS) conducted an audit of programme support costs at the United Nations Human Settlements Programme (UN-Habitat). The objective of the audit was to assess the adequacy and effectiveness of governance, risk management and control processes to ensure effective management of programme support costs at UN-Habitat. The audit covered the period from 1 January 2018 to 30 June 2020 and included a review of: (i) collection of revenue for programme support services; and (ii) distribution of programme support revenue.

The audit showed that internal controls relating to management of programme support costs need to be strengthened to enhance transparency and effectiveness.

OIOS made three recommendations. To address the issues identified in the audit, UN-Habitat needed to:

- Establish a mechanism to ensure that programme support costs are recovered in accordance with the United Nations policy and approvals are documented for any exceptions;
- Review and update the programme support cost rates used in Umoja based on agreements signed with donors; and ensure that programme support cost rates are specified and agreed with donors in cases where existing agreements do not specify such rates; and
- Develop clear and transparent criteria for collection and distribution of programme support revenue in accordance with ST/AI/286 and the guidelines issued by the Controller.

UN-Habitat accepted the recommendations and has initiated action to implement them.

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Audit of programme support costs at the United Nations Human Settlements Programme

I. BACKGROUND

1. The Office of Internal Oversight Services (OIOS) conducted an audit of programme support costs (PSC) at the United Nations Human Settlements Programme (UN-Habitat).
2. The General Assembly mandated UN-Habitat to promote socially and environmentally sustainable towns and cities with the goal of providing adequate shelter. Its vision is to have “a better quality of life for all in an urbanizing world” and its mission is “to promote socially and environmentally sustainable human settlements development and the achievement of adequate shelter for all”.
3. PSC refers to the charges collected on trust funds or extrabudgetary expenditures to efficiently and effectively finance the related programme support services. PSC is expressed as a percentage of direct costs, which ranges from 3 to 13 per cent, and is the method by which variable indirect costs are recovered or charged.
4. UN-Habitat collects PSC at different rates. According to the UN-Habitat Cost Allocation and Recovery Policy (1 June 2012), the standard PSC rates were: 13 per cent for normative projects, 10 per cent for operational projects, 7 per cent for joint programmes, and 5 per cent for emergency projects.
5. In 2018 and 2019, UN-Habitat collected PSC totaling \$10.2 million and \$9.5 million, respectively, from 20 trust funds. This was mainly collected from a technical cooperation trust fund (QXB Trust Fund) and a trust fund for other donors (FOD Trust Fund) that accounted for about 72 per cent and 22 per cent of the collections, respectively.
6. Comments provided by UN-Habitat are incorporated in italics.

II. AUDIT OBJECTIVE, SCOPE AND METHODOLOGY

7. The objective of the audit was to assess the adequacy and effectiveness of governance, risk management and control processes to ensure effective management of PSC at UN-Habitat.
8. This audit was included in the 2020 risk-based work plan of OIOS due to the risk that potential weaknesses in the administration and management of PSC could adversely affect the quality of support services provided to UN-Habitat’s programmes.
9. OIOS conducted this audit from June to September 2020. The audit covered the period from 1 January 2018 to 30 June 2020. Based on an activity-level risk assessment, the audit covered risk areas in the management of PSC which included: (i) collection of revenue for programme support services; and (ii) distribution of programme support revenue.
10. The audit methodology included: (a) interviews with key personnel; (b) review of relevant documentation; (c) analytical review of data; and (d) judgmental sample testing of transactions.
11. The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

III. AUDIT RESULTS

A. Collection of revenue for programme support services

UN-Habitat was updating its cost allocation and recovery policy

12. UN-Habitat operated 20 trust funds that generated revenue for its PSC. During 2018 and 2019, UN-Habitat's PSC revenue amounted to \$19.67 million, of which 94 per cent was generated by two trust funds – QXB and FOD. The other 18 trust funds accounted for the remaining 6 per cent (see Table 1).

Table 1: Major sources of PSC for UN-Habitat for 2018-2019

Trust Fund	2018 (\$)	2019 (\$)	Total (\$)	Proportion (%)
QXB	7,467,008	6,738,566	14,205,574	72
FOD	2,310,709	2,005,360	4,316,069	22
FHC	192,251	4	192,255	1
Others	220,223	733,149	953,372	5
Total	10,190,191	9,477,079	19,667,270	100

13. At the time of the audit, UN-Habitat, in coordination with the Controller, was revising its policies and procedures for collection and distribution of revenue for programme support service delivery. The UN-Habitat Cost Allocation and Recovery policy was outdated since it was superseded by the Controller's policy memorandum titled 'Cost recovery: Programme Support Costs' issued on 8 June 2012 to provide guidance on the application of PSC charges and the use of PSC revenue. Further, UN-Habitat's cost recovery policy had not fully taken into consideration the provisions of ST/AI/286 on programme support accounts. On 4 June 2018, UN-Habitat issued a draft cost recovery policy that was yet to be finalized. On 26 February 2020, UN-Habitat informed its Executive Board that it was aiming to present the new cost recovery policy at the Board's next session.

Adequate operational reserves were maintained

14. The Controller's memo of 8 June 2012 required UN-Habitat to maintain an operating reserve at 20 per cent of the estimated annual programme support income. The reserve is to be held in a separate account and used to protect against unforeseen shortfalls in delivery, inflation and currency adjustments or to liquidate legal obligations in case of abrupt termination of activities financed from extrabudgetary resources.

15. UN-Habitat maintained an operational reserve of \$2.9 million during the period 2018-2019 which was above the required 20 per cent threshold. UN-Habitat also maintained a programme support fund that stood at \$12.5 million as of 31 December 2019. This fund recorded deficits of \$972,000 in 2018 and \$2.3 million in 2019 due to challenges in mobilizing resources for implementation of its mandates. UN-Habitat was working to stabilize its income from various sources by developing an appropriate resource mobilization strategy for the period 2020-2023.

Need to use applicable PSC rates and guidelines

16. According to ST/AI/286 on programme support accounts, all trust funds (general and technical cooperation) should charge PSC for programme support services in their organizations. The United Nations policy on PSC (Controller's memo of 8 June 2012) provides a schedule of PSC rates to be applied on extra-budgetary expenditures. This is intended to provide simple, readily understandable and transparent PSC

rates and facilitate equal treatment of all donors. The prescribed PSC rates were as follows. Exceptions to these standard rates were to be referred to the Controller with justification for review and approval:

- (a) 13 per cent on all voluntary contributions where the United Nations retains primary and overarching programmatic responsibility and is the first or primary recipient of the funds.
- (b) 7 per cent on all voluntary contributions in support of inter-agency and 'Delivering as One' programmes and for collaborations with other multilateral institutions.
- (c) 3 per cent on all voluntary contributions for projects that are entirely implemented by other United Nations organizations, non-governmental organizations, or government services.

17. The standard PSC rates applied by UN-Habitat were different from those indicated in the Controller's memo. According to its policy, UN-Habitat applied PSC rates of 13 per cent for normative projects, 10 per cent for operational projects, 7 per cent for joint programmes, and 5 per cent for emergency projects. UN-Habitat staff were required to seek approval from the Director, Management and Operations Division (currently the Management Advisory and Compliance Division) or the Office of the Deputy Executive Director to vary the rates. In most cases, there was no evidence that UN-Habitat had provided justification and obtained the approval of the Controller to apply PSC rates that were different from the United Nations policy.

18. OIOS analyzed Umoja data pertaining to UN-Habitat grants from 1 January 2018 up to 30 June 2020 and noted partial compliance with the United Nations policy on PSC. In 65 per cent of the grants reviewed (937 out of 1,444), UN-Habitat applied the PSC rates indicated in the United Nations policy (13 per cent, 7 per cent or 3 per cent). However, in the remaining 35 per cent (507 out of 1,444 grants reviewed), UN-Habitat applied 28 different rates outside the schedule of rates provided for in the policy. For example:

- (a) In 179 grants involving \$157.1 million, no PSC was charged in Umoja, which was contrary to the United Nations policy. UN-Habitat explained that 16 of these grants were created erroneously and were not approved; 23 grants did not have Umoja transactions; and 29 grants had earned their PSC before Umoja was implemented.
- (b) In 286 grants involving \$537.1 million, 27 different PSC rates were applied that were different from the United Nations policy. There was no evidence of the Controller's approval for use of these different rates. UN-Habitat explained that 57 of these grants were funded by other United Nations entities or the European Union with PSC of at least 7 per cent.

19. UN-Habitat explained that it did not collect PSC on some grants due to the following:

- (a) 42 grants involving \$68.2 million were signed before 8 June 2012 when the UN-Habitat cost recovery policy was in effect. However, this practice was not in accordance with ST/AI/286.
- (b) Two grants involving \$0.2 million were technical cooperation grants funded by the United Nations Development Programme. However, ST/AI/286 requires charging PSC on technical cooperation grants.
- (c) 56 grants were un-earmarked funds from interest income, unclaimed surplus and other miscellaneous income that are considered core resources for UN-Habitat, and their use is at the sole discretion of the UN-Habitat and its Executive Board.

20. OIOS is of the view that all the above grants should have been charged PSC because ST/AI/286 was applicable at the time. On the use of the other 27 rates that were different from the rates in the United Nations policy, there was no evidence that waivers or exceptions were obtained.

21. UN-Habitat is exposed to the risk of under- or over-collecting of PSC revenue that is necessary for provision of effective support services for its programmes. The use of a wide range of PSC rates not only contravened the United Nations policy but was also inefficient and cumbersome to administer.

(1) UN-Habitat should establish a mechanism to ensure that: (i) programme support costs are recovered in accordance with the United Nations policy; and (ii) approvals are documented for any exceptions.

UN-Habitat accepted recommendation 1 and stated that it will establish a compliance mechanism and will liaise with the relevant departments at United Nations Headquarters to agree on an effective protocol for exceptions or waivers. Recommendation 1 remains open pending receipt of evidence that an appropriate mechanism has been established for recovery of PSC, and that relevant approvals are documented for any exceptions.

Need to ensure that correct PSC rates are applied in Umoja

22. There were errors in the PSC rates applied in processing of transactions in Umoja. In 2 out of 20 grants reviewed by OIOS, there were inconsistencies between the rate applied in Umoja and agreements signed with donors. A rate of 7 per cent was used in Umoja but there was no rate indicated in the Note Verbale (S1-32QXB-000265) with the Government of Japan dated 9 February 2015. On the other hand, in one agreement, S1-32FOD-000019, a rate of zero per cent was used in Umoja because no rate was specified in the signed memorandum of understanding between UN-Habitat and the donor. It was therefore not possible to assess if PSC revenue was over- or under-collected in the respective grant agreements.

23. Use of incorrect rates in Umoja could result in under- or over-collection of PSC revenue for programme support services, besides contravening the agreements entered into with the donors.

(2) UN-Habitat should: (a) review and update the programme support cost rates used in Umoja based on agreements signed with donors; and (b) ensure that programme support cost rates are specified and agreed with donors in cases where existing agreements do not specify such rates.

UN-Habitat accepted recommendation 2 and stated that in collaboration with the United Nations Office at Nairobi, it will review and update Umoja accordingly, and it will establish a monitoring mechanism to ensure that PSC rates are specified in agreements and are compliant with authorized rates. Recommendation 2 remains open pending receipt of evidence that PSC rates in Umoja are updated based on agreements signed with donors, and that PSC rates are specified and agreed with donors in cases where existing agreements do not specify such rates.

B. Distribution of programme support revenue

Need for more transparent and equitable distribution of programme support revenue

24. According to ST/AI/286, programme support resources should be used in areas where a demonstrable relationship exists between the supporting activity concerned and the activities which generated the programme support revenue. Furthermore, the United Nations policy on PSC (of 8 June

2012) requires that the use of programme support resources on extrabudgetary operations are supported with workload statistics of the related operations.

25. There was no mechanism at UN-Habitat to ensure that programme support resources were equitably used for the extrabudgetary operations that generated the revenue. For example, there were no workload statistics available to demonstrate equitable allocation of PSC to operations that generated the revenue. Also, there was no correlation between the generation of revenue by UN-Habitat's offices and allocation of the revenue to them for the support costs involved. For instance:

(a) While UN-Habitat's regional offices generated \$14.5 million out of UN-Habitat's total PSC revenue of \$20.2 million for 2018 and 2019, they were allocated only 4 per cent of the PSC revenue.

(b) UN-Habitat branches at its headquarters in Nairobi provide technical support to regional offices in project and programme management. While the branches generated \$3.9 million in 2018 and 2019, they were only allocated \$341,865.

(c) The UN-Habitat Central Administrative Division generated \$678,913 but was allocated \$8.7 million (or 68 per cent) of the PSC revenue for 2018 and 2019.

26. Interviews with key staff indicated that the disproportionate allocation of PSC revenue for support services was due to the following:

(a) Programme support funds have been used to compensate for growing deficits of the UN-Habitat Foundation funds.

(b) UN-Habitat's PSC revenue has declined in the last two years mainly due to its inability to compete with other cost-efficient service providers in the field that charge less than 13 per cent PSC.

(c) UN-Habitat did not have a clear, transparent criterion for allocation of PSC revenue.

(d) Lack of workload statistics to support the allocation of PSC revenue.

27. Key staff from regional offices stated that non-receipt of an appropriate proportion of PSC revenue was adversely affecting their operations. Due to insufficient resources, some offices were at risk of closure, and their activities were being reduced. This could have an adverse impact on effective delivery of UN-Habitat's programmes.

(3) UN-Habitat should develop clear and transparent criteria for collection and distribution of programme support revenue in accordance with ST/AI/286 and the guidelines issued by the Controller.

UN-Habitat accepted recommendation 3 and stated that it will develop transparent criteria for collection and distribution of PSC in accordance with the ST/AI/286 and the Controller's guidelines. Recommendation 3 remains open pending receipt of criteria developed for collection and distribution of programme support revenue in accordance with ST/AI/286.

IV. ACKNOWLEDGEMENT

28. OIOS wishes to express its appreciation to the Management and staff of UN-Habitat for the assistance and cooperation extended to the auditors during this assignment.

(Signed) Eleanor T. Burns
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STATUS OF AUDIT RECOMMENDATIONS

Audit of programme support costs at the United Nations Human Settlements Programme

Rec. no.	Recommendation	Critical ¹ / Important ²	C/ O ³	Actions needed to close recommendation	Implementation date ⁴
1	UN-Habitat should establish a mechanism to ensure that: (i) programme support costs are recovered in accordance with the United Nations policy; and (ii) approvals are documented for any exceptions.	Important	O	Receipt of evidence that an appropriate mechanism has been established for recovery of PSC, and that relevant approvals are documented for any exceptions.	31 December 2021
2	UN-Habitat should: (a) review and update the programme support cost rates used in Umoja based on agreements signed with donors; and (b) ensure that programme support cost rates are specified and agreed with donors in cases where existing agreements do not specify such rates.	Important	O	Receipt of evidence that PSC rates in Umoja are updated based on agreements signed with donors, and that PSC rates are specified and agreed with donors in cases where existing agreements do not specify such rates.	31 December 2021
3	UN-Habitat should develop clear and transparent criteria for collection and distribution of programme support revenue in accordance with ST/AI/286 and the guidelines issued by the Controller.	Important	O	Receipt of criteria developed for collection and distribution of programme support revenue in accordance with ST/AI/286.	31 December 2021

¹ Critical recommendations address those risk issues that require immediate management attention. Failure to take action could have a critical or significant adverse impact on the Organization.

² Important recommendations address those risk issues that require timely management attention. Failure to take action could have a high or moderate adverse impact on the Organization.

³ Please note the value C denotes closed recommendations whereas O refers to open recommendations.

⁴ Date provided by UN-Habitat in response to recommendations.

APPENDIX I

Management Response

Management Response

Audit of programme support costs at the United Nations Human Settlements Programme

Rec. no.	Recommendation	Critical ¹ / Important ²	Accepted? (Yes/No)	Title of responsible individual	Implementation date	Client comments
1	UN-Habitat should establish a mechanism to ensure that: (i) programme support costs are recovered in accordance with the United Nations policy; and (ii) approvals are documented for any exceptions.	Important	Yes	Director, MACS	December 2021	UN-Habitat will establish a compliance mechanism and will liaise with the relevant Departments in NYHQ to agree an effective protocol for exceptions/waivers
2	UN-Habitat should: (a) review and update the programme support cost rates used in Umoja based on agreements signed with donors; and (b) ensure that programme support cost rates are specified and agreed with donors in cases where existing agreements do not specify such rates.	Important	Yes	Director, MACS (recommendation 'a') Director GSD and Director RPD (recommendation 'b')	December 2021	UN-Habitat in collaboration with UNON will review and update Umoja accordingly and will establish a monitoring mechanism to ensure that PSC rates are specified in agreements and are compliant with authorized rates.
3	UN-Habitat should develop clear and transparent criteria for collection and distribution of programme support revenue in accordance with ST/AI/286 and the guidelines issued by the Controller.	Important	Yes	Director, MACS	December 2021	UN-Habitat will develop transparent criteria for collection and distribution of PSC in accordance with the ST/AI/286 and the Controller's guidelines.

¹ Critical recommendations address those risk issues that require immediate management attention. Failure to take action could have a critical or significant adverse impact on the Organization.

² Important recommendations address those risk issues that require timely management attention. Failure to take action could have a high or moderate adverse impact on the Organization.