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The UNOPS response to the Joint Inspection Unit review of management and administration in the United Nations Office for Project Services

Note by the Executive Director

The UNOPS Executive Director is pleased to transmit for the consideration of the members of UNDP/UNFPA/UNOPS Executive Board her comments and response to the Joint Inspection Unit review of management and administration in the United Nations Office for Project Services (JIU/REP/2018/3). The Board many wish to take note of the review and of the Executive Director's response and comments.

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I. Introduction

1. The Executive Director is pleased to transmit her comments and response to the Joint Inspection Unit review on management and administration in the United Nations Office for Project Services (JIU/REP/2018/3).

2. The review was conducted as part of the Joint Inspection Unit programme of work for 2017, as follow up to its 1998 report on the broader engagement of UNOPS with other United Nations organizations to strengthen effective cooperation by taking advantage of division of labour and complementarities. The review process was initiated by the Unit through a memo dated 1 March 2017, and was completed upon receipt by management, on 18 June 2018, of the Inspector's final draft of the report.

3. The objective of the Joint Inspection Unit was to provide an independent review of the regulatory frameworks and practices of UNOPS management and administration, with a view to identifying areas for improvement. The review focused on areas such as governance, executive management, oversight, strategic planning, risk management, and financial and human resources management.

II. General comments

4. The Executive Director is pleased to note the Inspector's recognition of the high degree of commitment and transparency of the executive management of UNOPS throughout the assessment process.[1] Innovation for efficiency and effectiveness lies at the heart of the strategic ambitions and entrepreneurial culture of UNOPS. It was therefore a priority to make managers and personnel available to respond to queries and swiftly provide data, analysis and other information requested by the Inspector.

5. UNOPS is committed to benchmarking the excellence of its operations against internationally recognized standards, and deploying best practices across all areas of its work. The Executive Director notes with appreciation the Inspector's confirmation that past efforts have been successful, and appreciates this opportunity to consider perspectives and reflections on strategic and tactical measures that may contribute to the continuous improvement of the organization and its management practices.

Viable business model

6. The Executive Board may wish to note the Inspector's recognition of the viability and success of the demand-driven and self-financed UNOPS business model, which over the past 20 years, through successive realignments of structure and business approaches, has been adapted to the needs of partners, within and outside the United Nations system, and to the evolving external environment.[2] The Inspector emphasised that the review confirmed the client-oriented and entrepreneurial UNOPS culture characterized by a strong business orientation, flexibility, and focus on adding value to the activities of its partners.[3]

Known value proposition

7. The Inspector noted that the UNOPS value proposition emphasizes operational excellence, technical expertise based on international norms and standards, experience and impartiality. She added that these traits are perceived by UNOPS partners as organizational strengths; and several partners consider UNOPS a critical component for the success of their own operations. The Inspector also noted that partners acknowledge the UNOPS appetite for innovation, and the fact that it is a one-stop shop for a wide range of services.[4]

Recognized agility and self-financed business model

8. In relation to the flexibility and agility of UNOPS, the Inspector noted that, encouraged by the General Assembly and the Executive Board, "UNOPS has successfully diversified and expanded its business, both for new partners and new service lines."[5] She highlighted that the Executive Board in 2017 reiterated its encouragement to the United Nations system "to recognize the comparative

[1] JIU/REP/2018/3, paragraph 4
[2] Ibid., p. iii
[3] Ibid., p. iii and paragraphs 135 and 167
[4] Ibid., paragraph 165
[5] Ibid., paragraph 169

advantage and technical expertise of UNOPS and to engage in collaborative strategic partnerships for efficiency and effectiveness, including at the country level".[6]

9. In relation to the UNOPS business model, the Inspector noted that "being a self-financed entity, UNOPS revenues are neither based on assessed nor voluntary contributions, but instead originate from the funds received from its clients for the delivery of projects and services".[7] With respect to the UNOPS activity-based cost-recovery model, the Inspector "commends the successful attempt to better identify and charge direct costs to clients considering UNOPS self-funding nature".[8]

10. Management feels it pertinent to emphasize that novel concepts such as risk- and value-based pricing and activity-based costing may seem unfamiliar and complex to a number of actors within and beyond the United Nations system. Nevertheless, these same concept and principles are regularly applied when the United Nations system procures goods and service from private sector agents which, unlike UNOPS, are oriented towards profits. Management would like to take this opportunity to emphasize its intent and practices to ensure cost-effectiveness and full transparency in the direct and indirect costs of the efforts UNOPS initiates in response to partner demand.

11. In section V.B. and annex VII the Inspector provided an overview of UNOPS project activities, summarizing the relative share of its delivery (turnover/direct costs), and net revenue (fee/indirect costs) in relation to its main service lines, sectors and partner groups. The annex included an overview of UNOPS delivery in relation to the types of countries of operation.

12. In its comments on the draft report, UNOPS encouraged the Joint Inspection Unit to draw this line of analysis to conclusion, inter alia, by illustrating the relationships between fee and turnover. Calculations based on the figures presented in the present report, illustrate that the indirect UNOPS margins (fee over turnover) are low: during the period 2014-2017 the overall average fee amounted to 5.25 per cent, and in 2017 it had reached an all-time low average of only 4.84 per cent. This suggests significant relative cost-effectiveness when compared to the 8 per cent fee typically charged by other organizations in the United Nations system, some of which may at the same time be funding indirect costs through core and other contributions.

13. The overall average fee results from the composition of the UNOPS portfolio of projects at a given time. It is an aggregate of all the individual projects, and multiple factors affects the fee for a particular project. As confirmed by the Inspector,[9] these factors include the service mix, size and nature of projects, as well as risk stemming from individual project complexities and/or the nature of the operational environment in which it is implemented. The general fee-level is also affected by continued pursuit on the part of UNOPS to optimize the cost effectiveness of its institutional enabling environment and global delivery platform.

14. It would be simplistic to assume that the individual fees of the 1,000 or so projects managed by UNOPS can be directly deduced based on the overall average. On the contrary, in order not to cross-subsidize unrelated activities undertaken on behalf of its partners, UNOPS recognizes that direct as well as indirect cost needs to be determined and attributed to each project. Direct cost thus includes costs of shared services, which will inevitably vary depending on the type of services a partner requires for a particular project. Indirect cost pertains primarily to institutional costs related to strategy, policy and control, as well as continued development of UNOPS partner relationships, its institutional enabling environment and its delivery platform.

15. The overall average fee and indirect costs established as a percentage of total expenditure provide an indication of institutional cost-effectiveness. Nevertheless, at the project level, a simplistic focus on fee and indirect cost as a percentage of the direct expenditure potentially distort focus and attention to the cost effectiveness of the latter – which is the bulk of any intervention – as well as to the ultimate value generated through the total expense incurred by the partner. While this is largely beyond the control of UNOPS, it does appear to be a systemic issue warranting attention, in the context of the ongoing United Nations system reforms, to ensure that the realization of envisaged outcomes is stimulated through appropriate incentive mechanisms.

16. In sum, the project-focused and differentiated approach to costing and pricing ensures the transparent attribution of costs to strategic and tactical efforts, and the discipline to avoid operational cross-subsidization for delivery of the diverse portfolio of projects, including contingencies for

[6] JIU/REP/2018/3, paragraph 169
[7] Ibid., paragraph 9
[8] Ibid., paragraph 99
[9] Ibid., paragraph 93

known project risks. Overall UNOPS margins (fees/indirect costs) are very low compared to public- and private-sector benchmarks, and internally UNOPS indirect costs are incurred prudently, with due consideration to ensuring institutional viability in the short, medium and longer term.

17. UNOPS maintains its management reserve at the minimum level established by the Executive Board[10] with a view to the unforeseen risks that may stem from its self-financed business model. That level was established to guarantee the financial viability and integrity of UNOPS as a going concern. Reserves beyond the minimum are maintained to enable potential strategic investments for growth and innovation, allowing for the mitigation of upside and downside risks emanating from changes in the external environment, and/or new requirements established by the Executive Board from time to time.

A resource with comparative advantage

18. In relation to the UNOPS comparative advantage to expand implementation capacity, the Inspector recalled and reaffirmed the emphasis of the 1998 report on a sharper division of labour between UNOPS and other United Nations system organizations based on their respective comparative advantages so as to optimize their complementarities;[11] and noted that since 1998 a number of external studies and reviews have drawn attention to the UNOPS advantage in implementation and management support services .[12]

19. Finally, the Executive Board may wish to note that during the review the Inspector identified a number of good practices followed by UNOPS that may be shared with other United Nations system organizations and may be beneficial to them in the context of implementing the 2030 Agenda for Sustainable Development, as well as in the ongoing United Nations system reform process.[13]

20. The overall findings of the Inspector attest to the viability of the UNOPS business model as established by the Executive Board and the General Assembly, and demonstrate that over the past 20 years UNOPS has been able to deploy change management for effective organizational reform.

Recommendations for continued improvement

21. Despite the confirmation of the success and relevance of UNOPS as a resource to expand implementation capacity for the United Nations system and beyond, its management recognizes that for any organization, ensuring institutional fit for purpose is a continuous process of improvement and innovation, building internal capabilities in response to changes in the external environment, and learning from experience.[14] It therefore appreciates the opportunity to consider the Inspector's perspectives and reflections on measures that may contribute to the continuous improvement of the organization and its management practices.

22. Based on the review, the Inspector presented formal as well as informal recommendations for continued improvement to be considered by the Executive Board and by UNOPS management. The recommendations spanned the functional scope of the areas covered during the review and were strategic and tactical in nature.

Formal recommendations

23. The Inspector presented three formal recommendations, two addressed to the Executive Board and one to the Executive Director of UNOPS. The Executive Director's comments and response to the formal recommendations are provided below.

Informal recommendations

24. The Inspector presented a number of informal recommendations for consideration. UNOPS will consider these for inclusion in the internal work plans of relevant functional managers during the present strategy period. Priority will be assigned and progress will be tracked as part of the UNOPS integrated approach to monitoring oversight recommendations. A status update on the recommendations may be provided as an annex to the midterm review, which will be presented the Executive Board in 2020.

[10] Decision 2013/33
[11] JIU/REP/98/5, paragraph 4
[12] Ibid., paragraph 171
[13] Ibid., paragraph 3
[14] DP/OPS/2017/5, paragraph 112

III. Comments on formal recommendations

A. Formal recommendations addressed to the Executive Board

External oversight

25. In paragraph 44 of the report of the Joint Inspection Unit, the Inspector formally recommended:

Recommendation 1

The Executive Board should adopt at its 2019 annual session revised terms of reference prepared by the Executive Director for the Audit Advisory Committee in compliance with good practices and established standards, notably with regard to the mandate, independence and composition of the committee and the procedures for the appointment of its members.

26. UNOPS is firmly committed to assessing its practices, including internal oversight and governance arrangements, against external standards, and to applying them with due regard to the relevant legislative decisions of the Executive Board and the General Assembly.

27. The Audit Advisory Committee was established through Executive Board decisions 2015/4 and 2015/12 pursuant to DP/OPS/2015/CRP.1, which proposed terms of reference comparable to those of the UNDP and UNFPA audit advisory committees. The Committee assumed the relevant functions of its predecessor, the Strategy and Audit Advisory Committee, which the Executive Board had established in 2008. In accordance with the provisions of decision 2008/37, the Chairs of the Audit Advisory Committee and the Strategy and Audit Advisory Committee provided annual reports to the Executive Board as an annex to the annual report on internal oversight. The Executive Board has consistently taken note of those annual reports.

28. In the rationale for the recommendation, the Inspector referred to the standards of the Institute of Internal Auditors. The Executive Board may wish to note that the reference point in the standards is an “independent audit committee”, defined as “a public sector organization board-level committee made up of at least a majority of independent members with responsibility to provide oversight of management practices in key governance areas”.[15] “It should play an independent oversight and advisory role, with responsibility for decision-making resting with management”.[16]

29. The Executive Board may wish to recall its decisions on the terms of reference for the Audit Advisory Committee. In decision 2015/4, the Board noted that “the advisory nature of the of the committee does not conflict with the functions of the Executive Board as laid out in General Assembly resolutions 48/162”.[17] The Board emphasized that the role of the Committee was to “provide independent views and findings regarding assurances to management and the Board on the audit and oversight functions of the organization”.[18]

30. In other words, while in most respects very similar to the definition of an “independent audit committee”, the “audit advisory committee” established by the Board in 2015, pursuant to its prior decisions 2008/37, 2009/4 and 2012/5, differs slightly – particularly with respect to its “advisory” nature and the emphasis on ensuring that it does not infringe on the strategic oversight role vested in the Executive Board through General Assembly resolution 48/162, nor duplicate the advisory function of the Advisory Committee on Administrative and Budgetary Questions. The Executive Board may wish to recall that those considerations were central in its consultations on the process for selection and appointment of committee members, which took place between the first regular and annual sessions 2015. They concluded with decision 2015/12, through which the full Audit Advisory Committee terms of reference were endorsed, with reference to best practices established by UNDP and UNFPA.

31. Notwithstanding the above, should the Executive Board, pursuant to its consideration of the Inspector’s recommendation and of its decisions 2015/4 and 2015/12, deem it warranted to materially change the mandate of the Audit Advisory Committee and other aspects of its terms of reference, the Board may wish to consider such changes in the context of related processes that may

[15] Independent Audit Committees in Public Sector Organizations, 2014, p. 4
[16] Ibid., p. 6
[17] Decision 2015/4, paragraph 3
[18] Ibid., paragraph 4

affect United Nations governance structures, including how a potential revision might affect other audit advisory committees under its purview.

32. The Board may also wish to consider changes in the context of General Assembly resolution 72/279, specifically in relation to the Secretary-General's proposal to gradually merge the New York-based Executive Boards.

33. The Board may wish to note that the Joint Inspection Unit, in its work programme for 2018, included a dedicated review of audit and oversight committees in the United Nations system. While that review is still ongoing, it may be useful for the Executive Board to consider its findings upon its completion.

34. Finally, the Board may wish to consider the financial implications of potential fundamental changes to the role and functions of the committee and its members. In accordance with the terms of reference, the present functions are fulfilled by its members on a pro bono basis. A Board-level committee might require honoraria for members and a dedicated secretariat.

35. Pursuant to the Inspector's recommendation on the composition of the committee and the process for identifying, screening and appointing new members, UNOPS will explore the feasibility of undertaking an executive search to identify a broader pool of qualified candidates. This would supplement current due diligence practices, including background and reference checks of potential candidates; notification of the Executive Board president of changes in membership; and annual confidentiality and 'no conflict of interest' affidavits by members. In addition, management will seek to address membership overlap with the UNOPS Strategic Advisory Group of Experts.

Financial framework

36. In paragraph 106 of the report of the Joint Inspection Unit, the Inspector formally recommended:

> **Recommendation 3**
>
> **The Executive Board should revisit at regular intervals the contingency provisions under UNOPS budget to determine the appropriate threshold of the Mandatory Operational Reserve and take a decision on UNOPS reserves portfolio, starting at its second regular session in 2019.**

37. Through its decision 2012/5, the Executive Board established the regulatory framework enabling the UNOPS transition from United Nations system accounting standards to the International Public Sector Accounting Standards.[19] The revised financial regulations and rules, including provision for the establishment of operational reserves, were approved pursuant to review and advice by the Advisory Committee on Administrative and Budgetary Questions.[20]

38. Regulation 22.02 of the UNOPS financial regulations and rules set out the types of reserves that may be established: "(a) An operational reserve at a level set by the Executive Board. The purpose of the operational reserve is to guarantee the financial viability and integrity of UNOPS as a going concern[; and] (b) A growth and innovation reserve to invest in the future revenue generating ability of UNOPS". It further stipulates that "transfers to this reserve will be limited to 50 per cent of the excess operational reserves, over and above the level set by the Executive Board. The specific approval of the Executive Board shall be required if the amount to be transferred exceeds 50 per cent of the excess operational reserve". Finally, it stipulates "(c) The decision to draw form these reserves shall rest solely with the Executive Director who shall report all drawdowns to the Executive Board".

39. The minimum level established pursuant to financial regulation 22.02 (a) included a mandatory requirement for the Executive Director to ensure that an operational reserve at this minimum level be maintained, whereas 22.02 (b) delegated to the Executive Director a conditional and discretionary authority to establish further dedicated reserves of the nature described.

40. While adoption of the financial regulations provided clear direction for the types of reserves that may be established, as well as on the associated authorities and responsibilities of the Executive Director, they did not set the reserve level deemed appropriate in accordance with International

[19] DP/OPS/2012/1, annex 1

[20] DP/OPS/2012/2, paragraph 13

Public Sector Accounting Standards. That was established through decision 2013/33, whereby the formula for establishing the minimum operational reserve requirement was revised.

41. Decision 2013/33 was informed by a comprehensive benchmarking study of practices in some 1,800 organizations with business models broadly comparable to that of UNOPS. The study was conducted over a period of several months and generated several best practice options for consideration by UNOPS management, the Advisory Committee on Administrative and Budgetary Questions, and the Executive Board. The report of the Advisory Committee on Administrative and Budgetary Questions on the study[21] emphasizes two main considerations supporting a new formula for the minimum management reserve: (a) almost all projects are pre-funded, and evident project-related risks are mitigated either by contractual clauses or as a consequence of the UNOPS business model – consequently, there are practically no risks immediately associated with the execution of projects that could influence the operational reserve level; (b) in accordance with the International Public Sector Accounting Standards, accruals related to end-of-service liabilities for personnel/retirees have to be built, as opposed to the United Nations System Accounting Standards, where these were considered part of the operational reserve. If earlier targets were to be maintained, those liabilities would effectively be double-counted, once by the accruals made and once by the operational reserve.

42. The minimum operational reserve requirement was subsequently approved by the Executive Board taking into account the transition from cash to accrual accounting. The formula for its calculation was established with a view to potential fluctuations in UNOPS financial activities and associated management expense, in order to protect the self-financed business model against the potential effects of unforeseen risks.

43. In its decision 2016/12, the Executive Board supported the creation of “a seed capital fund aimed at utilizing a portion of UNOPS operational reserves to make targeted contributions to early-stage investment projects in UNOPS mandated areas”. In other words, the Executive Board elaborated further and provided a specific example of how the Executive Director may consider operationalizing the authority granted through financial regulation 22.02 (b).

44. The UNOPS budget estimates are approved by the Executive Board every two years following advice from the Advisory Committee on Administrative and Budgetary Questions. In the UNOPS biennial budget estimates, 2018-2019,[22] UNOPS budgeted $20 million (11.2 per cent) of its estimated revenue for the period for strategic investments, and $26.6 million (14.8 per cent) for potential write-offs, provisions and contingency surplus. These are estimated allocations of potential management expense towards upside and downside risks that may or may not materialize over the two-year period. They should not be equated with the UNOPS operational reserve, as only their actual materialization, in conjunction with realization of estimated revenues, could affect any excess over the minimum reserve requirement in an upward or downward direction.

45. With regard to transparency of the potential or actual financial effect of downside risk, UNOPS, in accordance with the International Public Sector Accounting Standards, publicly discloses write-offs in respect of risks that materialized, and provisions for risks that may materialize in the future, including for relevant contingent liabilities. This is done annually through the audited financial statements presented to the General-Assembly and the Executive Board by the United Nations Board of Auditors.

46. In summary, management does not believe that the self-financed UNOPS business model has changed materially since the Boards decisions 2012/5 and 2013/33, nor does it find any evidence of such change in the Inspector’s report. On the contrary, the Inspector repeatedly confirmed the viability of the extant business model. Additionally, it is recognized best practice in the outside world that such formulas should not be revisited more frequently than once in 10 years. UNOPS management is therefore of the opinion that current regulations and financial reporting practices provide clear accountability and full transparency in relation to the issue under consideration. It is the considered opinion of management that there is no compelling reason at this time to revisit the formula governing the establishment of the operational reserves.

[21] See DP/OPS/2013/7 and DP/OPS/2013/CRP.1.

[22] DP/OPS/2017/6, table 3

B. Formal recommendation addressed to the Executive Director

Ethics framework

47. In paragraph 60 of the report of the Joint Inspection Unit, the Inspector formally recommended:

Recommendation 2

The Executive Director should strengthen the ethics framework, notably by (a) establishing a full time staff position of the Ethics Officer at senior level and (b) providing additional resources in the Management Budget 2019-2020 to ensure a more proactive ethics function.

48. UNOPS is firmly committed to the norms and standards of the United Nations, and to ensuring that ethical management and business practices are observed by its personnel. As observed by the Inspector, it has introduced a number of initiatives and efforts over the years to make sure that these are observed throughout the organization and its activities, most recently through the implementation of the governance, risk and compliance initiative.

49. Since 2009, the UNOPS Ethics Office has fulfilled its functions in accordance with the Secretary-General's bulletin on the United Nations system-wide application of ethics (ST/SBG/2007/11) and has been an important part of ensuring the UNOPS commitment to ethical conduct. In 2015, the resourcing of the function was reinforced considerably; nevertheless, UNOPS management is ready to further consider the level of resourcing.

50. UNOPS management concurs with the Inspector's recommendation that the Ethics Office should be headed by an incumbent of a senior-level staff position, and views favourably the proposal to enhance the proactive posture of the function, duly buttressed by a proportionate increase in its support resources.

51. UNOPS management will therefore proceed to strengthen the proactive posture of the ethics function, including the associated resourcing. Before the end of 2018 it will initiate the process to recruit the ethics officer at a senior-level staff position and augment the resourcing of the function. It will consider relevant benchmarks for other ethics offices in the United Nations system; decision 2018/14; and the UNOPS governance, risk and compliance initiative.