



United Nations

**United Nations Relief and Works Agency for
Palestine Refugees in the Near East**

Financial report and audited financial statements

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

Report of the Board of Auditors

General Assembly

Official Records

Fifty-seventh Session

Supplement No. 5C (A/57/5/Add.3)

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United Nations • New York, 2002

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Letters of transmittal

10 March 2002

Pursuant to financial regulations 11.4 and 12.1, I have the honour to submit the accounts of the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) for the biennium ended 31 December 2001, which I hereby approve. The financial statements have been prepared and certified as correct by the Comptroller.

May I take this opportunity to also confirm to you and to the stakeholders of the Agency that UNRWA has:

(a) An established and defined culture of accountability, an organizational architecture commensurate with the complexity faced in UNRWA operations, an internal control structure which is sound and functioning and a managerial structure which is transparent and utilized to keep managers informed of UNRWA activities, challenges and developments;

(b) Reporting processes that provide reasonable assurance that the UNRWA financial statements present fairly, in all material aspects, the results of operation and the financial position of UNRWA in accordance with generally accepted accounting principles;

(c) Cost-effective control systems, which provide reasonable assurance that the Agency's operational and quality objectives will be achieved. These objectives include, but are not limited to, reliable external disclosures, safeguarding of assets, prevention of fraud, compliance with the rules and regulations, elimination of unnecessary costs and maximization of income;

(d) Ongoing assessment and oversight processes, which review the significant internal control and risk issues identified by UNRWA internal and external auditors. UNRWA has initiated steps to adjust or add controls in areas where the risks associated with the non-achievement of UNRWA operational and quality objectives were considered to be excessive and/or unacceptable.

(Signed) Peter **Hansen**
Commissioner-General
UNRWA

The Chairman of the Board of Auditors
United Nations
New York

27 June 2002

I have the honour to transmit to you the financial statements of the United Nations Relief and Works Agency for Palestine Refugees in the Near East for the biennium 2000-2001 ended 31 December 2001, which were submitted by the Commissioner-General. These statements have been examined and include the audit opinion of the Board of Auditors.

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

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

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

Chapter I

Financial report for the biennium ended 31 December 2001

Summary

The United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) ended the biennium 2000-2001 with a net excess of income over expenditure of \$7.4 million for its regular budget activities. The closing balance of the Agency's working capital in respect of its cash regular budget activities amounted to \$8.5 million. This represents a significant improvement over the biennium 1998-1999, when the closing working capital stood at a negative amount of \$4.1 million (see statement 1).

The consolidated cash balance, which was \$31.0 million at the beginning of the biennium, increased by \$25.5 million to \$56.5 million as at 31 December 2001 (see statement 2). Of the \$56.5 million, \$10.2 million was committed for the Microfinance and Microenterprise Programme and \$9.3 million was earmarked for the purchase of basic commodities, leaving a balance of \$37.0 million available for funding project activities and regular budget operations.

The Agency's total regular and non-regular budget for the biennium was \$884.8 million (see statement 4). Against that, UNRWA received total income, including other income, of \$706.6 million during the biennium and spent \$659.7 million, resulting in a total excess of income over expenditure of \$46.9 million for the period. This excess was mainly accounted for by emergency appeal contributions received towards the end of the biennium, which had not been disbursed by the end of 2001.

As in the past, the education programme accounted for a major part of expenditure under the regular budget, with 58.7 per cent of total expenditure. The health programme was next, with 17.9 per cent, followed by operational and common services, with 13.2 per cent, and relief and social services with 10.2 per cent, as shown in the following table:

<i>Programme</i>	<i>Approved budget</i>		<i>Actual expenditure</i>		<i>Reduction</i>	
	<i>Percentage</i>	<i>US dollars</i>	<i>Percentage</i>	<i>US dollars</i>	<i>US dollars</i>	<i>Percentage</i>
Education	53.7	328 371 000	58.7	327 799 599	571 401	0.2
Health	17.6	107 703 000	17.9	100 191 537	7 511 463	7.0
Relief and social services	10.2	62 442 000	10.2	57 121 149	5 320 851	8.5
Operational and common services	18.5	112 767 000	13.2	73 384 116	39 382 884	34.9
Total	100.0	611 283 000	100.0	558 496 401	52 786 599	8.6

The overall reduction in expenditures of 8.6 per cent against budget was attributable to: (a) a shortage of contributions to meet budgeted expenditure; and (b) cost containment and strict financial management to match expenditure to income. The educational expenditures consisted mostly of teacher salaries. The total number of teachers increased owing to the increasing number of schoolchildren. In the health programme and in relief and social services, the reduction was due mainly to a decrease in the consumption of supplies. The contributing factors for the reduction of expenditures under operational and common services were decreases in staff and overhead costs and the non-utilization of a budgeted salary reserve of \$12 million and a working capital reserve of \$14 million.

Expenditure against non-regular budget funds during the biennium totalled \$94.0 million. The emergency appeal, post-1999 projects and Peace Implementation Programme absorbed a large portion of this expenditure, at \$57.7 million, \$16.9 million and \$16.1 million respectively.

The net assets of the Area Staff Provident Fund decreased to \$787.8 million, and the market value of the investments at the end of the biennium was \$788.8 million. The losses attributable to the members of the Provident Fund, as at 31 December 2001, totalled \$4.1 million.

A. Overview

1. The United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) was established by the General Assembly in its resolution 302 (IV) of 8 December 1949 as a separate entity within the United Nations system. The Agency's mandate has been renewed repeatedly, most recently by Assembly resolution 56/52 of 10 December 2001, when it was extended until 30 June 2005.

2. UNRWA reports directly to the General Assembly. A 10-member Advisory Commission, which includes representatives of the Agency's major donors and host Governments, undertakes an annual review of UNRWA programmes and activities.

B. Activities of the United Nations Relief and Works Agency for Palestine Refugees in the Near East

3. UNRWA provides educational, health and relief and social services to some 3.9 million Palestine refugees in Jordan, Lebanon, the Syrian Arab Republic and the West Bank and Gaza Strip. The headquarters of the Agency are located in Gaza and Amman.

4. The Agency has continuously adapted its role and services in keeping with the needs of the refugees and the changing environment in which it operates. Throughout its 52 years of humanitarian service in the area, the Agency has demonstrated a capacity to adapt and enhance its programmes as required to cope with developments in the region, and stands ready to continue doing so in accordance with the mandate it receives from the General Assembly.

5. A number of challenges for the work of UNRWA have arisen since the outbreak of strife in the occupied Palestinian territory in September 2000. The unstable security context, deteriorating economic conditions for the refugees and the restrictions on the flow of goods, services and labour have greatly increased demands on the Agency's humanitarian operations in the Gaza Strip and the West Bank.

1. Education programme

Mission

6. The mission of the Agency's education programme is to help Palestine refugee children and youth acquire the basic knowledge and skills needed to become productive members of their communities in accordance with the needs of the labour market, as well as their identity and cultural heritage.

Objectives

7. The objectives of the programme are as follows:

(a) Provision of a general education to Palestine refugee children and youth at the elementary and preparatory levels, as well as at the secondary level, on a limited basis, in Lebanon only;

(b) Provision of university-level pre-service teacher education for young Palestine refugees as well as in-service teacher education for UNRWA teachers to enable them to improve the quality of education in UNRWA schools;

(c) Provision of vocational and technical education and training for young Palestine refugees to enable them to become skilled, productive citizens and contribute to the well-being of their communities;

(d) Provision of job placement assistance for the graduates of the Agency's vocational training centres and enhancing career guidance and counselling services for the Agency's preparatory and secondary school students as well as vocational and technical graduates.

Results

8. During the biennium 2000-2001, 477,216 and 486,026 children were enrolled for the school years 2000/01 and 2001/02 respectively in the Agency's 644 elementary, preparatory and secondary schools (the latter in Lebanon only), which were staffed by 14,494 teachers. In addition, a total of 255,141 refugee pupils attended other government and private elementary, preparatory and secondary schools at no cost to UNRWA. During the biennium, vocational, technical and teacher education was provided at the Agency's eight training centres and by three science education faculties for 6,008 and 5,896 students enrolled for the 2000/01 and 2001/02 training years respectively. Some 569 and 567 instructors taught in those training centres during the two years of the biennium respectively. In-service teacher training courses were provided by the Institute of Education at UNRWA headquarters in Amman through five educational development centres for 538 and 648 education staff members in the two school years respectively. In addition, 400 teachers were trained in the Gaza Strip during the two school years. Under the Agency's scholarship programme, which was funded entirely from earmarked donor contributions, 427 and 197 students were awarded university scholarships for the academic years 2000/01 and 2001/02 respectively. The education programme no longer provides funding for scholarships. The Agency's expenditure on the education programme in the biennium was \$327.8 million against the General Assembly-approved budget of \$328.4 million. Educational expenditure represented 58.7 per cent of the Agency's regular budget expenditure.

9. The distribution of expenditures for educational services by activity and field is shown below:

2. Health programme

Mission

10. The mission of the Agency's health programme is to protect, preserve and promote the health status of the registered Palestine refugees and to meet their basic health needs consistent with the basic principles and concepts of the World Health Organization, as well as with the standards achieved by the public health sector in the Agency's area of operations.

Objectives

11. The objectives of the programme are as follows:

(a) Preserving the sustainable investment achieved in primary health care by implementing appropriate intervention strategies with a high potential impact on health outcomes, especially in the areas of disease prevention and control and maternal and child health;

(b) Enhancing the process of institutional capacity-building in order to maximize system performance, improve service quality and increase efficiency and cost-effectiveness;

(c) Maintaining environmental health conditions in refugee camps compatible with the levels provided by local municipalities by implementing developmental projects to improve camp infrastructure for water, sewerage and drainage and solid waste disposal;

(d) Harmonizing health policies and service standards with those of the host authorities in order to make optimal use of scarce resources and avoid incompatible priorities;

(e) Preventing breakdowns in service delivery, quality and sustainability by responding to emergency situations arising as a result of the Arab-Israeli conflict.

Results

12. The Agency offers comprehensive primary health-care services to Palestine refugees in the five areas of operation, comprising disease prevention and control and maternal and child health care, including family-planning services. Those services are provided through 122 primary health-care facilities. During the biennium, a total of 14,545,387 visits were made to these clinics by refugee patients for medical and dental consultations and other treatment, such as injections and dressings. Assistance towards hospitalization is provided either at contracted hospitals or through partial reimbursement of costs. UNRWA also runs a small hospital in Qalqilia in the West Bank, and operates six maternity units integrated within the largest health centres in the Gaza Strip. Under hospitalization assistance, refugees treated during the biennium at UNRWA hospital and maternity units and at contracted hospitals utilized a total of 285,609 bed-days. Environmental health services are also part of the health programme, as is the supplementary feeding programme for pregnant women and nursing mothers. Total expenditure on the health programme for the biennium amounted to \$100.2 million against the General Assembly-approved budget of \$107.7 million. The health programme accounted for 17.9 per cent of the Agency's regular budget expenditure.

13. The distribution of health programme expenditures by activity and field is depicted below.

3. Relief and social services programme

Mission

14. The mission of the Agency's relief and social services programme is to provide the most disadvantaged Palestine refugees with humanitarian assistance and to promote the self-reliance of less advantaged members of the refugee community, such as women, youth and the physically challenged. The Department of Relief and Social Services also serves as the custodian of the historical records of some 3.9 million Palestine refugees.

Objectives

15. The objectives of the programme are as follows:

- (a) Providing the neediest eligible families with basic subsistence support;
- (b) Improving the housing conditions of "special hardship" families;
- (c) Delivering targeted assistance to families with small-scale emergency needs during an economic or humanitarian crisis;
- (d) Strengthening the institutional capacity of community organizations in the camps to better serve the needs and promote the rights of the physically and mentally challenged, youth and women;
- (e) Updating monthly and maintaining daily the content of the computerized registration records of approximately 3.9 million refugees;
- (f) Maintaining the capacity to respond to large-scale emergencies, with a special focus on the short-, medium- and long-term programmatic demands of the 2000/01 intifada in the West Bank and Gaza Strip on the Agency's relief and social services;
- (g) Maximizing the use of limited resources through increased operational efficiencies, inter-agency and interdepartmental cooperation, ongoing consultation with host authorities, programmatic, funding and professional collaboration with local and international non-governmental organizations and various cost-sharing and self-help mechanisms.

Results

16. At the end of 2001, 225,156 refugees (of whom 208,805 were ration recipients) were enrolled in the special hardship programme, representing 5.7 per cent of the total registered refugee population. They belonged to 56,963 families, with an average of four persons per family receiving “special hardship” assistance. This assistance consists of food, a small cash subsidy, shelter rehabilitation, preferential access to vocational and teacher training and small grants or loans to establish individual or group “self-support” projects. Social workers provided counselling and support to help families cope with the difficulties causing or aggravating their socio-economic problems. Selective cash assistance for those in extreme distress was continued in 2001, with a total of \$500,000 distributed among the five field locations. The Department of Relief and Social Services continued its poverty alleviation programme (providing credit opportunities) and related skills training. Technical and financial support focused on building up the capacity of 135 community-based organizations (for women, youth and the disabled) to become managerially and financially sustainable. During the biennium, approximately 143,033 refugees participated in the activities of those organizations. The Agency’s eligibility and registration staff continued to update the field registration system database on 3.9 million refugees, in addition to the field social study system database, which tracks the socio-economic data of the special hardship families. Total expenditure on the relief and social services programme during the biennium amounted to \$57.1 million against the General Assembly-approved budget of \$62.4 million. Relief and social services expenditure represented 10.2 per cent of the Agency’s regular budget expenditure.

17. The charts below reflect the distribution of relief and social services expenditure by activity and field.

4. Operational, technical and common services

18. The mission of the Agency’s operational and technical services is to enhance and create synergy in the functions of the Agency’s information systems, procurement, logistics and construction and engineering services. It is also to direct those services to achieve the best results in terms of efficiency, reliability and timeliness, hence contributing to the Agency’s mandate in providing humanitarian assistance to Palestine refugees.

19. The mission of the Agency's common services, comprising general management and administration, is to secure the highest standards of efficiency, competence and integrity in carrying out the UNRWA humanitarian mandate deriving from the relevant General Assembly resolutions, in providing leadership to the Agency's programmes and fields and in managing the Agency's human and financial resources.

20. Expenditure during the biennium for those services amounted to \$73.4 million against the General Assembly-approved budget of \$112.8 million. This expenditure represented 13.2 per cent of the Agency's regular budget expenditures.

5. Special programmes

21. In addition to the ongoing services described above, during the biennium 2000-2001 UNRWA implemented the special programmes outlined below to improve the living conditions of Palestine refugees, with earmarked funding from donors.

Emergency appeals

22. In view of the deteriorating economic situation as a consequence of the strife in the West Bank and Gaza Strip since September 2000, UNRWA launched three emergency appeals during the biennium to assist the refugee community in the affected areas. The major thrust of the emergency operations was to provide essential food supplies, shelter, selective cash assistance, employment generation and medical assistance, including physical rehabilitation and counselling for the several thousand people injured or disabled as a result of the clashes. Against a total for all three emergency appeals of \$160 million, the donor community pledged \$130.9 million in cash and in-kind assistance. Of this total, \$101.3 million was received by the end of December 2001, of which \$26.2 million was received during the last quarter of the year. To enable the immediate implementation of emergency relief activities, an advance of \$1.2 million was received in November 2000 from the Central Emergency Revolving Fund towards meeting the emergency needs of the Palestine refugees. This advance is to be repaid by March 2002. The total expenditure under the emergency appeals amounted to \$57.7 million.

Post-1999 projects

23. During the biennium, a new category of post-1999 projects was established to replace the closed and/or phased-out projects under the Peace Implementation Programme, capital and special projects and expanded programme of assistance. During the biennium, \$23.8 million was received for projects under this category and expenditure was \$16.9 million.

Peace Implementation Programme

24. The Peace Implementation Programme was launched in October 1993 following the signing of the Israeli-Palestinian Declaration of Principles in September of that year. Under the programme, the Agency undertook special construction and development projects in the West Bank and Gaza Strip with the objectives of developing infrastructure, improving living conditions and creating employment opportunities. Those objectives were pursued mainly in areas where UNRWA was already playing a significant role, such as in educational and vocational training, health care and environmental sanitation, microfinance and microenterprise activities and relief assistance and social services. Those development projects were later extended throughout the UNRWA area of operations for the benefit of all Palestine refugees. During the biennium, the programme received \$3.3 million, while expenditure was \$16.2 million, including the use of funds received in previous years.

Lebanon Appeal

25. The Lebanon Appeal was issued to help alleviate the socio-economic conditions of the 365,000 Palestine refugees registered in Lebanon. Most of those refugees suffered from deplorable living conditions and depended almost entirely on UNRWA for basic services. The deteriorating socio-economic situation in the country, combined with the inability of the refugees to gain full access to the job market or to avail themselves of public health facilities, heightened their desperation and misery. As the regular funding available to UNRWA was insufficient to cope with the growing needs of the refugees in Lebanon, the Agency launched a special emergency appeal in July 1997 in Geneva, seeking \$11 million in additional contributions to support essential health, educational and relief and social services. During the biennium, total expenditure incurred on specific Lebanon Appeal project activities was \$1.7 million, using funding received in 1997.

Capital and special projects

26. Activities funded under capital and special projects are undertaken only if earmarked funding is available. Capital projects represent investment to upgrade and expand facilities in the Agency's regular programmes, namely schools, health clinics and community centres. Special projects consist of ongoing activities related to the Agency's regular programmes, which donors have agreed to fund separately on a recurrent basis but which are not considered part of the regular programmes, such as training centres and scholarships. Expenditure on such projects during the biennium was \$1.1 million.

Expanded Programme of Assistance

27. The Expanded Programme of Assistance was established in 1988 to improve living conditions in refugee communities and to upgrade the Agency's infrastructure throughout its area of operations, with special emphasis on the West Bank and Gaza Strip. The programme was subsumed into the Peace Implementation Programme in October 1993, and the Agency began to phase it out as projects were completed. A total of \$0.3 million was spent to complete Expanded Programme of Assistance projects during the biennium under review.

Microfinance and Microenterprise Programme

28. The mission of the Microfinance and Microenterprise Programme is to improve the quality of life of small and microentrepreneurs, sustain jobs, decrease unemployment and provide income-generating opportunities to poor men and women through the provision of credit.

29. Since June 1991, the Microfinance and Microenterprise Programme in the West Bank and Gaza has helped to promote small business development, create employment, improve the income of microenterprises and reduce poverty through the establishment of a number of targeted credit programmes aimed at small businesses, microenterprises and women. The small and microenterprise training component of the programme endeavours to meet the emerging standards for business training and business development services, where it covers all the direct costs of training from participants' fees and meets its overhead and administrative costs from donor contributions. The programme is organized around three revolving loan funds in Gaza and two in the West Bank. The programme, which is of a commercial nature, supports businesses varying in size from a microvending enterprise employing just one or two individuals to small industries, and aims to satisfy a variety of needs, such as capital funding and working capital financing. Since it was established, the programme has distributed \$60.31 million through 47,382 loans (38,724 loans valued at \$48.82 million in Gaza and 8,658 loans valued at \$11.48 million in the West Bank). The total disbursement for the biennium was \$20.85 million on 20,743 loans, as depicted below:

Income-Generation Programme

30. The Agency's Income-Generation Programme, which operates under the supervision of the Relief and Social Services Department's poverty alleviation programme, aims to support Palestine refugees who require financing of income-generating projects in Jordan, the Syrian Arab Republic and Lebanon. The Programme is much smaller in volume than the Microfinance and Microenterprise Programme, with an outstanding portfolio of \$0.97 million and accumulated reserves of \$1.50 million as at 31 December 2001. Another significant feature of the Programme is its social orientation, whereby loans are granted to eligible borrowers at subsidized rates of interest.

C. Financial results

31. At the end of the biennium, the Agency's overall surplus was \$46.9 million on its operations, as shown in statement 1, income and expenditure, which also shows the balances of the Agency's working capital and other funds. The balances of the other funds are earmarked for specific purposes. The working capital under the Agency's regular budget fund is not a statutory operating reserve, but is the difference between the assets and the liabilities of the fund. The working capital account is used for three specific purposes: (a) to meet temporary current-year imbalances in the cash flow; (b) to finance unforeseen needs; and (c) in the event of a curtailment of the Agency's activities, to meet any extraordinary liquidating liabilities. As shown in statement 1, the working capital account of the regular budget had a positive balance of \$17.8 million. This is accounted for by the following:

(a) A positive working capital balance of \$9.3 million earmarked for in-kind purchases of basic commodities;

(b) A positive working capital balance of \$8.5 million on all other regular cash budget operations during the biennium.

32. For efficient cash-flow management, the Agency centrally manages all cash received for both the regular and non-regular budget. The statement of cash flow for the period, statement 3, depicts the changes in the Agency's financial position and reflects the consolidated cash balance of \$56.5 million at the end of the biennium.

33. Statement 4 shows the Agency-wide budgeted and actual expenditures for the biennium. The Agency expended \$659.7 million during the biennium against a budget of \$884.8 million on all its activities. On the regular budget alone, the expenditure was \$558.5 million against a budget of \$611.3 million. A graphical comparison of the regular budget actual expenditure versus the budgeted expenditure is shown below.

34. Financial statements of the Area Staff Provident Fund, shown separately in the present report, indicate that the total assets of the Fund declined to \$787.8 million from \$856.6 million during the previous biennium. The Fund's net investment income for the biennium was \$46.1 million, compared with \$102.1 million for the previous biennium. Due to the negative performance of equity markets during 2001, the losses attributable to the participants of the Fund as at 31 December 2001 amount to \$4.1 million.

35. A diagram of UNRWA accounts for the biennium 2000-2001 follows.

Chapter II

Report of the Board of Auditors

Summary

The Board of Auditors has reviewed the operations of the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) and has audited the financial statements for the biennium ended 31 December 2001. The audit included visits to both Agency headquarters, at Gaza and Amman, as well as to the UNRWA field offices in the Syrian Arab Republic, Gaza and Amman.

The Board's main findings were as follows:

(a) UNRWA paid end-of-service benefits of \$27.1 million during the biennium, although the related provision amounted to only \$18.4 million. Also, the estimated liability of \$143.6 million was unfunded and did not include international staff and repatriation grants;

(b) The Board was unable to obtain adequate assurance as to the reasonableness of the value of land and buildings (\$317 million) and the value of the non-expendable equipment balance for the Jordanian and Syrian field offices;

(c) Unliquidated obligations were not always reviewed periodically by the certifying or alternate certifying officials;

(d) Two tax authorities subjected UNRWA to direct taxes and customs duties, contrary to the Convention on the Privileges and Immunities of the United Nations, the balance of which amounted to \$26.8 million and remained outstanding at the end of the period;

(e) Various donor-specified projects had been pre-financed as at 31 December 2001. Major projects amounting to \$4,989,529 were pre-financed, of which \$3,561,977 was still outstanding at the end of April 2002;

(f) UNRWA could further optimize efficiency and effectiveness and reduce headquarters costs resulting from the operation of two headquarters;

(g) The vacancy rates at UNRWA headquarters were 14.8 per cent in Amman and 20.8 per cent in Gaza;

(h) Various areas of the Agency's internal audit function could be improved.

The Board's main recommendations are that UNRWA should review the funding mechanism to fully fund end-of-service liabilities; ensure proper custody and control of equipment; review and recover long-outstanding balances; further optimize the efficiency and effectiveness of headquarters expenditures; revise its recruitment strategy; and further improve aspects of the internal audit function.

A list of the Board's main recommendations is provided in paragraph 11.

A. Introduction

1. The Board of Auditors has audited the financial statements of the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) for the period from 1 January 2000 to 31 December 2001, in accordance with General Assembly resolution 74 (I) of 7 December 1946. The audit was conducted in accordance with article XII of the Financial Regulations and Rules of the United Nations and the annex thereto, and with the common auditing standards of the Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency. Those standards require that the Board plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement.

2. The audit was conducted primarily to enable the Board to form an opinion as to whether the expenditures recorded in the biennium 2000-2001 had been incurred for the purposes approved by the governing bodies, whether income and expenditures had been properly classified and recorded in accordance with the Financial Regulations and Rules and whether the financial statements of UNRWA presented fairly the financial position at 31 December 2001 and the results of the operations for the period then ended. The audit included a general review of the financial systems and internal controls and a test examination of accounting records and other supporting evidence to the extent that the Board considered it necessary to form an opinion on the financial statements.

3. In addition to the audit of the accounts and financial transactions, the Board carried out reviews under regulation 12.5 of the Financial Regulations and Rules of the United Nations. The reviews concerned the efficiency of financial procedures, the internal financial controls and, in general, the administration and management of UNRWA. The audit was carried out at UNRWA headquarters in Gaza and Amman and at the field offices in Gaza, the Syrian Arab Republic and Amman. The final audit, in April 2002, could be conducted only from the Amman headquarters because of the security situation in Gaza.

4. During the period under review, the Board continued its practice of reporting the results of specific audits through management letters containing detailed observations and recommendations to the Administration. This practice helped to maintain an ongoing dialogue with the Administration on audit issues.

5. The present report covers matters which, in the opinion of the Board, should be brought to the attention of the General Assembly. The Board's observations and conclusions were discussed with the Administration, whose views, where appropriate, have been reflected in the report. The report covers the audit of both financial and management issues.

6. A summary of the Board's main recommendations is contained in paragraph 11. The detailed findings are reported in paragraphs 13 to 122.

1. Previous recommendations not fully implemented

7. In accordance with section A, paragraph 7, of General Assembly resolution 51/225 of 3 April 1997, the Board has reviewed the action taken by the Administration to implement the recommendations made in its report for the period

ended 31 December 1997¹ and confirms that, in general, there are no important outstanding matters.

8. In accordance with General Assembly resolution 48/216 B of 23 December 1993, the Board also reviewed the measures taken by the Administration to implement the recommendations made in its report for the financial period ended 31 December 1999.² Details of the action taken and the comments of the Board are set out in the annex to the present report.

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

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

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

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

10. The Board noted that the Administration had generally complied with those requirements.

2. Main recommendations

11. The Board recommends that UNRWA:

(a) **In conjunction with United Nations Headquarters, review the funding mechanism and targets for end-of-service liabilities in line with policies adopted by other United Nations organizations (para. 30);**

(b) **Implement the asset module included in the newly acquired financial management system as a matter of urgency in order to rectify deficiencies in the management and control of fixed assets. In addition, proper asset counts should form the basis of validating data in the asset module, and the assets should be properly stated in the financial statements and the notes thereto in terms of the Agency's accounting policy (para. 34);**

(c) **Review unliquidated obligations on a regular basis to ensure the validity of such obligations and cancel obligations that are no longer required (para. 38);**

(d) **Strengthen its efforts to recover the outstanding tax reimbursement of \$26.8 million and make further appeals to the relevant administrations to fully accept the tax-exempt status of the Agency (para. 41);**

¹ *Official Records of the General Assembly, Fifty-third Session, Supplement No. 5C* (A/53/5/Add.3), chap. II.

² *Ibid.*, *Fifty-fifth Session, Supplement No. 5C* and corrigendum (A/55/5/Add.3 and Corr.1), chap. II.

(e) Review its policy on the pre-financing of donor-specified projects in view of the adverse effects it could have on the implementation of other projects and the impact on the cash flow of UNRWA (para. 53);

(f) Evaluate headquarters operating costs with a view to further optimizing efficiency and effectiveness. This evaluation should cover both quantifiable aspects and non-quantifiable matters (para. 61);

(g) Revise its recruitment strategy to lower the number of vacancies at headquarters to an acceptable level to enable the Agency's functions to be performed in the most efficient and effective manner (para. 65);

(h) Improve its Audit and Inspection Department quality assurance process by documenting and retaining appropriate evidence of supervision. Furthermore, the Department should conduct internal quality assurance reviews on a regular basis (para. 103).

12. The Board's other recommendations are shown in paragraphs 20, 24, 26, 43, 45, 50, 70, 73, 76, 78, 82, 90, 92, 97, 101, 106, 110, 115 and 121.

B. Financial issues

1. Overview

13. Contributions to regular budget funds, which continued to be the main source of the Agency's income (82 per cent), amounted to \$575.1 million for the biennium 2000-2001, compared with \$538.1 million for the previous biennium. Contributions to non-regular budget funds also increased, from \$42.6 million in the biennium 1998-1999 to \$128.5 million for the biennium 2000-2001. The Administration attributed the increase in income under the regular budget to its intensified efforts to generate revenue. The increase in non-regular budget funds for the biennium 2000-2001 was the result of funds received for the emergency appeal, amounting to \$101.2 million. The total combined income for all funds amounted to \$706.6 million (including an offset of net exchange losses of \$4.5 million), compared with \$586.1 million for the previous biennium.

14. Expenditure from the regular budget funds amounted to \$558.5 million, while expenditure from other funds amounted to \$101.2 million. The combined actual expenditure therefore amounted to \$659.7 million, compared with \$584 million for the previous biennium.

15. The total combined income of \$706.6 million for all funds fell short of the budgeted expenditure of \$884.8 million by \$178.2 million for the biennium 31 December 2001, although the actual combined expenditure for the biennium amounted to \$659.7 million. **There was a surplus of \$49.5 million (including a prior-year adjustment of \$2.6 million) of income over expenditure for the biennium 2000-2001, compared with a surplus of \$2.08 million for the biennium 1998-1999.** This excess was attributable mainly to the Emergency Appeal, which realized a surplus of income over expenditure of \$43.5 million for the biennium 2000-2001 because the funding was received late in the biennium and will therefore not be expended until the biennium 2002-2003. The surplus of \$43.5 million will be carried forward, in accordance with UNRWA practice.

16. The Board was pleased to note that as a result of the Administration's efforts, an increase in both the regular budget and non-regular budget contribution income (some 21 per cent over the prior biennium) was achieved.

2. United Nations system accounting standards

17. The Board assessed the extent to which the financial statements of UNRWA for the biennium 2000-2001 conformed to the United Nations system accounting standards. The review disclosed that the presentation of the financial statements was generally consistent with the standards. However, certain aspects of the presentation needed to be modified to bring the statements fully in line with those standards. The main area for attention was that costs incurred during construction and major long-term acquisitions that extended over more than one financial period had not been disclosed in a separate account in accordance with paragraph 50 of the accounting standards. These construction work-in-progress costs amounted to \$7,065,038 as at 31 December 2001.

18. Paragraph 50 of the accounting standards also requires that the source of financing of the operations be disclosed separately. Note 9 to the UNRWA financial statements on land and buildings presents information that is contrary to this. According to the note, the costs had been disclosed by including them in the land and building figure as a result of the introduction of a new set of accounts. Such costs would be disclosed separately in the accounts for the next biennium. According to paragraph 16 of the accounting standards, wrong or inappropriate treatment of items in the financial statements is not rectified either by disclosure of accounting policies used or by explanatory material.

19. UNRWA informed the Board that with the implementation of the new financial management system, it would be possible to disclose the information in future periods.

20. The Board recommended that UNRWA disclose the value of construction work in progress in the financial statements in order to comply with paragraph 50 of the United Nations system accounting standards, and UNRWA agreed.

3. Presentation of financial statements

21. The objective of the financial statements is to provide information about the financial position and performance of the organization and changes in its financial position, as well as to ascertain its compliance with legislative and other authorities. The Board reviewed the presentation of the financial statements of UNRWA as at 31 December 2001 to assess the extent to which UNRWA had implemented the Board's recommendations made in respect of the financial statements for the biennium ended 31 December 1999.² The Board was pleased to note that UNRWA had implemented the previous recommendations made regarding the financial statements.

22. The Board identified additional aspects that could lead to further improvement of the financial statements. Only the balance of capital acquisitions, amounting to \$317,045,314 for land and buildings and \$65,795,282 for other fixed assets were disclosed in the notes to the financial statements. However, no details regarding the movements (acquisitions, disposals and write-offs) were provided. Furthermore, UNRWA capitalized its land and buildings, whereas it had expensed such transactions in the prior biennium. This represented a change in accounting policy

and also resulted in the restatement of prior-year balances. Details of the change in accounting policy and the restatement of amounts were not disclosed in the notes to the financial statements.

23. UNRWA has some 74 bank accounts in various currencies, with a total cash balance of some \$56.5 million as at 31 December 2001. UNRWA had revalued its monetary assets to their fair value in compliance with paragraph 21 of the accounting standards. The Board is of the opinion that the risks relating to foreign currency and the methods used to minimize them would be valuable information to the users of the financial statements. In this regard, international accounting standard 39 provides useful guidance on the recognition, measurement and disclosure of financial assets and liabilities.

24. **The Board recommended that UNRWA provide more details on:**

(a) **Capital acquisitions, disposals and write-offs made during the biennium to reflect movements from the opening to the closing balance;**

(b) **Changes in accounting policy and the restatement of prior-year amounts regarding land and buildings in the notes to the financial statements;**

(c) **Risks relating to foreign currency and the Agency's risk-management objectives in the notes to the financial statements.**

UNRWA agreed that it would do so to the extent possible.

25. Statement 1 also reflects net adjustments of \$2.7 million in respect of the prior year with regard to reclassifications and restatements resulting from changes in the financial regulations as well as recommendations of the Board. The Board noted that the disclosure in the notes to the financial statements could be improved to better explain the prior-year adjustments in detail.

26. **The Board recommends that UNRWA improve its disclosure in the notes to the financial statements to adequately explain the prior-year adjustments.**

4. End-of-service benefits

27. The Agency's accumulated separation benefits for area staff were estimated at \$143.6 million as at 31 December 2001. The estimate was based on the Agency's current costs and regulations and rules. The separation benefits included accrued leave, termination indemnities and retirement benefits. **The Board is concerned, however, that this liability of \$143.6 million in respect of staff termination benefits was still unfunded as at 31 December 2001.** UNRWA informed the Board that the estimated liability did not include international staff, since the United Nations would meet the cost of those separation benefits.

28. The amount of total reserves of \$88.4 million as at 31 December 2001 (statement 2) was inadequate to meet the estimated liability. UNRWA indicated that owing to the lack of donor funding, the reserve had been discontinued in 1984, but that it would recreate the reserve should funding be forthcoming. UNRWA has a limited mandate, which was extended until 30 June 2005 by the General Assembly in its resolution 56/52 of 10 December 2001. The Board recognizes that UNRWA has limited resources, but the termination benefits represent a legal liability that the Agency would have to liquidate in the event that it ceased its operations.

29. The Board noted that UNRWA had provided, via the payroll, for anticipated retirement and separation benefits in the budget for each biennium. **During the biennium 2000-2001, a provision of \$18.4 million was made, whereas the actual payments relating to retirement and separation benefits totalled \$27.1 million, resulting in a deficit of \$8.7 million that was not budgeted.** Due to the fact that a reserve did not exist for end-of-service benefits, the difference had to be funded from savings made within the staff cost budget. Accordingly, the savings on staff costs arose primarily from the high vacancy rate and the recruitment of new staff under the 1999 area staff rules, which have a lower cost structure than the pre-1999 area staff rules.

30. **The Board recommends that UNRWA, in conjunction with United Nations Headquarters, review the funding mechanism and targets for end-of-service liabilities in line with policies adopted by other United Nations organizations.**

5. Asset management

31. **An asset register was not being maintained for control over land and buildings valued at \$317 million.** UNRWA responded that, despite not having a specific fixed asset register, the Engineering and Construction Service Division, as the custodian of all properties, maintained a comprehensive database of land and buildings. However, the Board noted that the listing was maintained for insurance and maintenance purposes, as the values on which the listing was based (replacement/market values) did not agree with the amount in the financial statements, which is based on historical cost. A fixed-asset module was purchased with the new financial management system, but it had not been implemented at the time of the audit. UNRWA informed the Board that the implementation of the new system would facilitate more control over assets.

32. Furthermore, the UNRWA office in Jordan could not provide asset registers for assets amounting to \$9.7 million. Also, the asset listing made available by the Syrian field office included an opening balance of \$5 million for which no details could be given and for which the related value card references were incomplete. The Board was also unable to verify the assets in Gaza and the West Bank at the time of the audit owing to the security concerns in the Middle East. The Board did note that inspections on land and buildings and on non-expendable equipment were performed periodically to verify the existence of the assets.

33. **The Board, therefore, was unable to obtain adequate assurance that the value of land and buildings of \$317 million, based on historical cost, as stated in statement 2, was reasonable. Also, the Board could not obtain assurance that the non-expendable equipment balances for the Jordanian and Syrian field offices included in the consolidated balance of \$65.8 million in the notes to the financial statements were reasonable.**

34. **The Board recommends that UNRWA implement the asset module included in the newly acquired financial management system as a matter of urgency in order to rectify the deficiencies in the management and control of fixed assets. In addition, proper asset counts should form the basis of validating data in the asset module, and the assets should be properly stated in the financial statements and the notes thereto in terms of the Agency's accounting policy.**

6. Unliquidated obligations

35. The Board noted that there was a significant increase in unliquidated obligations over the past three bienniums, with a significant increase of 396 per cent from the biennium 1996-1997 (\$1,026,616) to the biennium 1998-1999 (\$5,094,656), and a further increase of 53 per cent for the biennium 2000-2001 (\$7,792,475).

36. Unliquidated obligations, as a percentage of expenditure to which they relate, also increased consistently, as shown in table 1.

Table 1
Unliquidated obligations in relation to expenditure

<i>Biennium</i>	<i>Expenditure (United States dollars)</i>	<i>Unliquidated obligations (United States dollars)</i>	<i>Percentage</i>
1996-1997	651 533 223	1 026 616	0.16
1998-1999	583 973 686	5 094 656	0.87
2000-2001	659 702 027	7 792 475	1.18

37. The Board noted that included in the unliquidated obligations as at 31 December 2001 were obligations outstanding since 1998, 1999 and 2000 amounting to \$303,263, \$31,407 and \$388,032 respectively. This, along with the fact that included in those totals are amounts as immaterial as \$9, was an indication that the unliquidated obligations were not always reviewed periodically by the certifying or alternate certifying official.

38. The Board recommended that UNRWA review unliquidated obligations on a regular basis to ensure the validity of such obligations and cancel the obligations that are no longer required, and UNRWA agreed.

7. Accounts receivable

39. **The Board noted that two tax authorities had subjected UNRWA to direct taxes and customs duties totalling \$27 million, contrary to the Convention on the Privileges and Immunities of the United Nations.** In spite of the efforts of UNRWA, it was able to recover only \$184,958 of the total amount, leaving a balance of \$26,815,042 outstanding as at April 2002. It was further noted that outstanding customs and port charges included in the aforementioned balance had increased from \$4.1 million for the biennium 1998-1999 to \$7.2 million (75 per cent) for the biennium 2000-2001 and that no customs and port charges had been recovered since June 1994.

40. The Board indicated in paragraph 42 of its previous report² that \$23.7 million was outstanding as at 31 March 2000 in respect of direct taxes and customs duties. The non-recovery of those balances result in the Agency's working capital being tied up in customs duties and value-added taxes and results in a potential loss of interest income that would have been earned had the funds been available. UNRWA informed the Board that it was vigorously pursuing the recovery of outstanding taxes and that since February 2002 it had been granted a value-added tax rating of zero for goods and services equal to or exceeding a value of \$1,000 in Gaza.

41. **The Board reiterates its recommendation that UNRWA strengthen its efforts to recover the outstanding tax reimbursement of \$26.8 million and that it make further appeals to the relevant administrations to fully accept the tax-exempt status of the Agency.**

42. **No age analysis reports were prepared during the biennium 2000-2001 for the ageing of debts.** An age analysis is a critical control measure to ensure that all accounts receivable are followed up on a timely basis to reduce the possibility of losses due to write-offs. An accounts receivable module was not available on the previous financial system, and a module for accounts receivable was purchased but had yet to be implemented in the new financial management system at the time of the audit. UNRWA informed the Board that it had aggressively pursued the collection of outstanding receivables using manual subsidiary ledgers.

43. **The Board recommends that UNRWA implement the accounts receivable module in order to follow up receivables balances in a timely manner.**

44. At the request of the Board for an age analysis of accounts receivable, UNRWA prepared an age analysis report for account 125 (miscellaneous claims and receivables), which indicated that the total amount of receivables outstanding for 120 days and longer was \$1.4 million, of which \$1.3 million related to the headquarters in Gaza.

45. **The Board recommended that UNRWA take appropriate action to resolve the long-outstanding amounts, and UNRWA agreed.**

8. Cash management

46. The Board noted that the cash-flow position of UNRWA remained critical owing to repeated funding shortfalls in previous years that had severely eroded the Agency's cash reserves. **As at 31 December 2001, the Agency had outstanding cash pledges under all accounts totalling \$23.4 million, of which \$18 million had been received by the time of the audit.**

47. As at 31 December 2001, unfunded expenditures of \$5 million that had been incurred in the biennium 1998-1999 still existed in the 2000-2001 accounts in respect of the transfer of the Agency's headquarters from Vienna to Gaza. UNRWA was seeking the United Nations Secretariat's assistance in settling this amount.

48. The result of this shortfall is that UNRWA missed an opportunity to strengthen its cash-flow situation because of the loss of interest income that could have been earned if all the above amounts had been received in a timely manner.

49. Further discussion with management revealed that the cash-flow shortages were of a cyclical nature in the sense that at the beginning of the biennium, UNRWA was in a good cash-flow situation as contributions were being received. However, as the biennium progressed, cash-flow shortages were experienced because certain contributions were not being paid.

50. **The Board recommends that UNRWA conduct continuous follow-up on all outstanding contributions as well as long-outstanding debts.**

51. UNRWA informed the Board that the difficulty of the cash flow situation was caused mainly by shortfalls in the funding of activities and delays in the follow-up

of pledges by donors. UNRWA was therefore making efforts to broaden its donor base to raise additional funds.

52. In paragraph 41 of its prior report,² the Board noted that \$24.2 million had been applied from the regular budget to pre-finance specific projects and that that amount was outstanding at 31 December 1999. **The Board again noted that various donor-specified projects had been pre-financed as at 31 December 2001.** Projects amounting to \$4,989,529 were pre-financed, of which \$3,561,977 was still outstanding as at the end of April 2002. Pre-financing of projects could have an effect on the implementation of other projects where the contributions for the pre-financed projects were not received in time. UNRWA indicated that there was no written policy on pre-financing and, in the interest of speedy project implementation, allotted funds were advanced against confirmed pledges. Some donors insisted on conditioning their project funding on a reimbursement basis.

53. The Board reiterates its recommendation that UNRWA review its policy on the pre-financing of donor-specified projects in view of the adverse effects it could have on the implementation of other projects and its impact on the cash flow of UNRWA.

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

54. In line with UNRWA financial regulation 11.5, the Administration provided the Board with details on losses of cash and other non-expendable property written off during the biennium 2000-2001. This included the loss of cash amounting to \$447. It was also noted that non-expendable property totalling \$1,401,213 (based on original cost) had been written off in accordance with financial regulation 10.4. The amounts written off in respect of non-expendable property resulted from the loss of assets during the relocation of the Agency's headquarters from Vienna to Gaza in 1996, as commented on by the Board in paragraph 52 of its report on UNRWA for the biennium 1998-1999.²

10. Ex gratia payments

55. In line with UNRWA financial regulation 11.5, the Administration provided the Board with four cases of ex gratia payments totalling \$13,979 in respect of the following:

- (a) \$2,000 to a former staff member pursuant to a United Nations Administrative Tribunal judgement;
- (b) \$1,522 to a trainee as compensation for personal injury suffered in an accident (out-of-court settlement);
- (c) \$10,000 to the parents of an UNRWA pupil who was killed in a fatal accident during school hours;
- (d) \$457 for medical insurance based on a past judgement.

C. Management issues

1. Agency headquarters

56. During 1995 and 1996, UNRWA headquarters were moved from Vienna to Amman and Gaza City. UNRWA headquarters provide operational and support services to the primary operations of the organization. The common functions provided by the Amman and Gaza headquarters during the biennium included but were not limited to:

- (a) Administrative and transport services (telephone operator, mail, travel assistants, receptionists, drivers, etc.);
- (b) Human resources services;
- (c) Financial and accounting services;
- (d) Public information services;
- (e) Information system services.

57. The Board noted that UNRWA had reduced the duplication of functions by varying the nature and extent of services provided by the two headquarters. However, both UNRWA headquarters had evolved into sizeable operations. **Efficiency and cost-effectiveness could be further improved in such areas as travel expenditures and staff costs.**

58. With regard to travel costs, expenditures for the biennium 2000-2001 amounted to some \$2,051,245. Of that amount \$718,639 (35 per cent) and \$822,274 (40 per cent) was incurred in respect of the Gaza and Amman headquarters respectively. UNRWA could not readily provide details as to the portion of travel costs incurred for meetings and other coordination activities between the two headquarters, that is, for travel from Gaza to Amman and vice versa. However, based on discussions with senior management of UNRWA and our own observations, such travel between the two headquarters occurs frequently as, to the Agency's credit, it places emphasis on effective coordination and collaboration between the two headquarters.

59. The UNRWA headquarters in Gaza has a higher cost for international staff than the one in Amman. International staff in Gaza were paid a post adjustment of 10.7 per cent compared with 3.9 per cent for their counterparts in Amman (rates as at July 2001). Also, an extended monthly evacuation allowance was paid to Gaza-based international staff and varied depending on level. UNRWA could not readily provide the Board with the actual expenditure incurred as a result of the post adjustment, as this was included as part of the total salary cost. In respect of evacuation allowances, an expenditure of \$1,004,997 was incurred for the current biennium. Gaza international staff also received a hazard duty allowance of \$603,556 for the current biennium. In addition to these obvious direct staff costs, UNRWA incurred indirect costs resulting from the establishment of two headquarters, such as non-productive hours spent on travel between the two headquarters, delays and complications at border crossings and increased communication costs.

60. The recent security concerns in the Middle East, especially in Gaza, and the fact that the audit had to be performed from the Amman headquarters because of the

security concerns in Gaza were a further indication that the nature and location of specific services should be re-evaluated.

61. The Board recommends that UNRWA evaluate headquarters operating costs with a view to further optimizing efficiency and effectiveness. This evaluation should cover both quantifiable aspects and non-quantifiable matters.

62. UNRWA agreed that maintaining multiple headquarters locations was not an ideal situation but that it was doing its utmost to minimize the negative impact of the arrangement. Because of the current political situation, conducting an evaluation of the benefits of merging the two locations at this stage would not be beneficial.

2. Human resources

63. UNRWA vacancy rates in certain of the offices were relatively high in comparison with one another and the budgeted vacancy rate. Table 2 illustrates the various vacancy rates for area staff per office as at December 2001:

Table 2
Vacancy rates as at December 2001

<i>Location</i>	<i>Total posts</i>	<i>Vacant posts</i>	<i>Vacancy rate (percentage)</i>
Amman headquarters	223	33	14.8
Gaza headquarters	154	32	20.8
Vienna	4	1	25.0
Gaza field office	7 396	185	2.5
Jordan field office	6 168	367	6.0
Lebanon field office	2 672	202	7.6
Syrian Arab Republic field office	2 881	147	5.1
West Bank field office	3 655	215	5.9
Total	23 153	1 182	5.1

64. The highest vacancy rates were at the headquarters — Amman (14.8 per cent) and Gaza (20.8 per cent). The budgeted vacancy rate for area staff was 2 per cent. For the 130 established international posts, 23 (17.7 per cent) were vacant as at December 2001. UNRWA informed the Board that the main reason for the vacancy rate at the Gaza headquarters for international staff was the security concerns in the area, and that it was therefore difficult to find suitable staff willing to work there. The high vacancy rate in Amman was due to the ongoing restructuring of the Information Systems Division.

65. The Board recommends that UNRWA revise its recruitment strategy to lower the number of vacancies at headquarters to an acceptable level enabling the Agency's functions to be performed in the most efficient and effective manner.

3. Internal audit

66. The Board conducted a detailed review of the Agency's internal audit function, which was vested in its Audit and Inspection Department. The findings of that review and the Board's recommendations are set out below.

International auditing standards

67. The Institute of Internal Auditors redefined internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations and that helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk-management, control and governance processes.

68. The Board noted that that definition had also been discussed at the UNRWA audit committee meeting on 20 April 2000, and that it was agreed that such a definition could well be applied to the UNRWA internal audit function.

69. The Institute of Internal Auditors is an international association dedicated to the continuing professional development of the individual internal auditor and the internal auditing profession. The standards for the professional practice of internal auditing issued by the Institute are the criteria by which the operations of an internal auditing department are evaluated and measured. The 2002 standards were adopted at the June 2002 meeting of representatives of internal audit services of the United Nations organizations.

70. The Board recommended that the Audit and Inspection Department conform to the standards for the professional practice of internal auditing and the code of conduct established by the Institute of Internal Auditors, and the Department agreed.

Departmental practices

71. Article XII of the UNRWA financial regulations provides for the establishment of an internal audit function. The mandate of the internal audit function is further expanded upon in organization directive No. 3, and organization directive No. 14 sets out the responsibilities and activities of the Audit and Inspection Department. The directive is a substitute for the conventional internal audit charter and covers the features that would normally be reflected in the charter. The Board was pleased to note that the Department reports directly to the Commissioner-General and has unrestricted access to all records and information.

72. The Commissioner-General, following a recommendation of the Audit Committee in April 2000, approved the expansion of the functions of the Audit and Inspection Department to include performance audits. However, the Board noted that the mandate of the Department remained unchanged.

73. The Board recommended that the mandate of the Audit and Inspection Department be updated regularly to reflect the recent changes and expectations, and UNRWA agreed.

Personnel

74. Not all of the Audit and Inspection Department staff have all the competencies required to provide the required assurance, particularly in the transition phase from a

narrow financial compliance focus towards a more value-adding operational focus. The Board encourages the Department to compare the competencies of the existing staff to the required competencies once the extent and levels of assurance required have been determined. Staff may then be afforded the opportunity to acquire the required competencies.

75. The Audit and Inspection Department informed the Board that enquiries had been made at various internationally recognized institutions and that a verbal confirmation of gratis training had been received from the Audit Bureau of Jordan, for which a formal training programme had been developed. Furthermore, it was noted that staff of the Department had attended a basic investigative training course.

76. The Board recommended that UNRWA develop a formal professional development strategy with a view to providing up-to-date technical knowledge and competencies to ensure that the Audit and Inspection Department collectively obtains the required competencies and skills.

Use of technology

77. Information technology can generally assist in the recording of audit work, the standardization of working papers and reports, data interrogation and analysis, and administrative functions. The Department made use of information technology only for sampling purposes and, consequently, computer-assisted auditing techniques were not generally used and the available software (Idea) was underutilized. The Board noted that funding for training in this area was needed, but that the Department would identify training opportunities and, if necessary, seek additional funding.

78. As the application of computer-assisted auditing techniques is applicable in all information technology environments, the Board recommended that the application of such techniques be extended to increase the effectiveness and efficiency of the internal audits, and UNRWA agreed.

Internal auditing practices

79. Risk assessment is defined in the standards of the Institute of Internal Auditors as a systematic process for assessing and integrating professional judgements about probable adverse conditions and/or events. The risk-assessment process should thus provide a means of organizing and integrating professional judgements for the development of the audit work schedule.

80. The Director of the Audit and Inspection Department compiled the 2001 auditing work plan taking into account the results of the previous year's audits, especially those not completed; data gathered during the year; and senior management's responses to a request for input. However, no evidence could be provided that risks had been analysed in a structured way to establish where and how the Department should focus its attention. More specifically:

- (a) Not all auditable activities and their relevant risk factors had been identified;
- (b) The relative significance of the various risks had not been assessed;
- (c) No consideration had been formally given to the control environment to assess residual risks.

81. The Board noted that a risk assessment identifying audit projects to be performed had been completed for each year of the biennium 2002-2003, but no detailed programme indicating the time frames and resources per project on a monthly basis had been developed to date.

82. The Board recommended that the Audit and Inspection Department develop a detailed programme indicating the time frames and resources per project for all audit assignments that were expected to be carried out in 2002 and beyond.

Performing individual audits

83. The Audit and Inspection Department performs mainly the following types of assignments:

- (a) Compliance audits;
- (b) Financial audits;
- (c) Performance audits (evaluations of efficiency, effectiveness and economy);
- (d) Information technology audits.

84. During the biennium 2000-2001, the Department issued 32 reports of which 8 (25 per cent) were financial audits, 10 (31 per cent) were compliance audits, 9 (28 per cent) were performance audits and 5 (16 per cent) were information technology audits.

85. The compliance audits are conducted using the Financial Regulations and Rules of the United Nations and other approved guidelines as the source of compliance, while the financial audits are conducted using the audit programmes contained in the Audit Manual.

86. The UNRWA Audit Committee recommended that all Audit and Inspection Department staff be given appropriate training in the application of the new guidelines on performance auditing and apply the same criteria in future audits. The Board concurred with the recommendation of the Audit Committee and encouraged the Department to expedite the completion of such tasks.

87. A review of certain working paper files covering a range of audits revealed that the level of planning varied among the various auditors but that, generally, sufficient background information had been obtained to ensure a clear understanding of the function or area that had been audited. It is good practice to properly plan individual audits to ensure that significant areas of audit activities are identified and covered during the audit. There was, however, no evidence that the audit programmes had been reviewed before the commencement of the audits.

88. A number of working paper files were selected in order to evaluate the quality of working papers, sampling and other selection procedures and the quality of evidence and to review fieldwork and completion procedures. Working papers were generally found to have been sufficient to demonstrate that the standards of the Institute of Internal Auditors with regard to the various stages of the audit had been adhered to, namely, planning, scope, fieldwork and reporting. The quality of supporting evidence was evaluated for its relevancy in terms of achieving the stated

objectives and was generally found to be sufficient. Generally, there was no evidence that working papers had been reviewed.

89. The Board found that the Audit and Inspection Department could improve on completion procedures. In order to comply fully with the standards of the Institute of Internal Auditors, the following areas needed to be considered:

- (a) Evidence that the file has been reviewed, ensuring that conclusions have been reached and agreed between all sections of the working papers and the report;
- (b) Assurance that all audit steps have been performed;
- (c) Evidence of adequate follow-up and resolution of problems highlighted during the audit and recommendations made by the auditors.

90. With regard to the overall process for performing individual audits, the Board recommended that the Audit and Inspection Department adequately review the audit working papers, in a timely manner and at the appropriate level, in compliance with Institute of Internal Auditors standards, and the Department agreed. The Department also agreed to improve on the completion procedures as they relate to file reviews, completeness and follow-up.

Reporting on audits

91. The timeliness of reporting by the Audit and Inspection Department was of concern. An analysis of specific audits revealed that in certain instances it took UNRWA more than six months to issue the final report after the fieldwork had been completed. The risk of delayed reporting is that the conditions prevailing during the audit might have changed significantly, and therefore the efforts and results obtained by way of the audit could have been negated.

92. The Board recommended and UNRWA agreed that stricter time frames should be established and enforced to improve and strengthen the processes of reporting and follow-up.

93. UNRWA informed the Board that the Department would adopt appropriate means to compare actual against budgeted time for review and to follow up variances.

Supervision

94. The Director of the Audit and Inspection Department was responsible for supervision in terms of the Institute of Internal Auditors standards, which cover the total audit process, from the planning of the audit up to the conclusion of the audit assignment. The extent of supervision was, however, dependent on the skill and proficiency of the auditors used as well as the complexity of the audit.

95. It was acknowledged that the internal auditors were qualified and experienced, but there was no evidence that the following formal procedures had been followed:

- (a) Communicating audit instructions at the start of audits;
- (b) Ensuring that the approved audit programme was carried out and that any deviations in terms of scope or time spent were properly justified;
- (c) Determining that the preset audit objectives have been met.

96. In this regard, it was noted that an overall review checklist had been completed for each audit project, but little evidence was found of a review having been done with regard to specific audit working papers and the supervision process.

97. The Board recommended that the Audit and Inspection Department strengthen supervisory responsibilities, as appropriate, as well as its documentation of the supervisory review, and the Department agreed.

Performance measurement

98. The Board noted that weekly time sheets were being kept for each staff member for the recording of time allocated against the various audit projects and indirect activities. This information was summarized after the completion of the audit, but no comparison was done against the budgeted audit time for review and follow-up of the variances.

99. Furthermore, it was noted that the above-mentioned time sheets were inadequate to monitor the actual audit time against budgeted time during the performance of the audit project, since the time was not captured for each audit stage (planning, execution and reporting). Therefore, budget overspending could not be readily identified and specifically remedied.

100. With regard to the assessment of the status of the implementation of the Audit and Inspection Department recommendations, a response and recommendation implementation table was implemented for each audit project. However, the Department has not made provision on this table for follow-up of the responses received from the specific responsible departments.

101. The Board recommends that the Audit and Inspection Department develop, implement and monitor detailed time sheets. The Department agreed to amend the table of recommendations to provide for follow-up of specific responses, and agreed that a summarized table should be kept for overall follow-up and review purposes.

Quality assurance

102. The Audit and Inspection Department did not apply a formal quality assurance system — either through direct supervision of work performed or through the review of working papers or regular internal or external quality assurance reviews. The Board noted that an external peer review was performed by the Office of Internal Oversight Services in March 2002. The only type of quality control that was evident was the review of the individual audit reports by the Director before they were signed off for release.

103. It is acknowledged that the degree of supervision is dependent on the proficiency of the internal auditors and the degree of complexity of the respective audits. **However, the Board recommends that the Department improve its quality assurance process and that it furthermore conduct internal quality assurance reviews on a regular basis.**

104. UNRWA informed the Board that the Department would further improve its quality assurance process by documenting and retaining appropriate evidence of supervision, including internal quality assurance, on a regular basis. The Department

was also in the process of implementing the recommendations made in the peer review.

4. Information and communication technology

Disaster recovery plan

105. The Board noted that, although the Information Systems Office operating manual did refer to a disaster recovery plan, a formal written updated and approved plan for UNRWA did not exist.

106. The Board recommends that UNRWA update the disaster recovery plan for all areas.

107. UNRWA informed the Board that the disaster recovery plan would be given a high priority after the implementation of the Information System Division restructuring.

Programme change control procedures

108. The Board noted that during the period under review, changes were made in production programmes relating to the existing application systems; however, no programme change control procedures existed to effect changes in the application systems. UNRWA was not able to address the issue of its structure and resources at the time of the audit.

109. The Board noted that programmers had access to the production environment for the transfer of changes, which allowed them to write, test and implement as well as maintain the programmes. The risk existed that the programmers could make unauthorized changes, which could lead to fraud being perpetrated and financial loss to UNRWA.

110. The Board recommended that UNRWA formally compile, document and approve programme change control procedures covering the entire process, from the initial change request to the eventual migration of the change into the production environment, and UNRWA agreed.

Systems development life cycle

111. The Board reviewed the systems development life-cycle methodology followed by UNRWA for the implementation of the new finance and payroll systems that were developed by a supplier.

112. UNRWA has entered into a contract amounting to \$1,370,345 for the implementation and maintenance of the combined payroll and finance system. However, no formal systems development life-cycle methodology had been developed. Without the guidance provided by such a methodology, control over the design and implementation of new applications and the achievement of business and application control requirements might not be feasible.

113. It was noted that the Reality software package, which was purchased in October 1992, included an asset management module. The non-utilization of this module could be regarded as wasted expenditure, of which the value could not be determined as the contract provided for an overall price for the system.

114. UNRWA indicated that, because of incompatibility with the Agency's system, customization of the Reality module had not been pursued since priority was given to the other modules. This indicates that proper systems development life-cycle methodology was not followed, which resulted in the Agency's purchasing an incompatible module.

115. The Board recommends that UNRWA develop a formal systems development life-cycle methodology to govern the process of developing, acquiring, implementing and maintaining computerized information systems and related technology.

116. UNRWA informed the Board that the development of a systems development life-cycle methodology was a major task to be undertaken by a proposed head development unit, to be established as part of the restructuring of the Information System Division.

5. Cases of fraud and presumptive fraud

117. The Administration informed the Board of three cases of fraud that had come to its attention during the biennium 2000-2001. Two cases involved a total loss to UNRWA of \$1,004. The Administration recovered \$986, leaving a balance of \$18 outstanding as at 31 December 2001. Two staff members' appointments were terminated. The other case related to the use of UNRWA letterhead stationery and its official stamp in order to obtain favourable tariffs and to take advantage of the Agency's tax-free status. Two staff members were immediately suspended, one of whom was subsequently reinstated. The inquiry was still in progress at the time of the audit.

118. In the biennium 1998-1999, the Office of Internal Oversight Services conducted an investigation into allegations of corruption and fraud in an UNRWA field office, following reports in the news media. No evidence substantiating the allegations were found. In November 2000, the Audit and Inspection Division investigated fraud and corruption in one field office relating to payroll costs and resulting from collusion among employees. Fortunately, UNRWA was able to recover the money to the extent that it had been defrauded. Further cases have been noted by the Department, which were being investigated.

119. The Board noted that the senior management of UNRWA, the Department and their staff took a strong stance against matters of fraud and potential fraud. **The Board also notes that UNRWA included elements of fraud prevention in different rules and procedures, but did not have a formal structured fraud-prevention plan.** Fraud prevention cannot be achieved with regulations and internal controls alone, but rather with a proactive strategy and a resulting structured plan.

120. The Board believes that a well-structured and well-implemented plan could also have the benefit of increasing donor confidence in UNRWA. In developing the fraud prevention plan, UNRWA should consider:

- (a) Establishing a corruption and fraud prevention committee to serve as an effective framework and coordination point for a corruption and fraud prevention plan;
- (b) Implementing comprehensive and well-communicated organizational systems, policies and procedures;

(c) Developing and implementing a formal corruption and fraud response plan setting out procedures for reporting of fraud by employees and subsequent follow-up steps;

(d) Conducting ethics, corruption and fraud-awareness training sessions and workshops among managers, international and area employees and other stakeholders;

(e) Strengthening existing detection mechanisms and developing new ones;

(f) Developing appropriate resolution mechanisms for reported and detected incidents and allegations of corruption and fraud.

121. The Board recommends that UNRWA develop its own fraud-prevention plan, including fraud-awareness initiatives. In developing the plan, UNRWA should discuss features of it with the United Nations and other funds and programmes to obtain the benefits of best practices, where available, in specific elements or all of the elements being considered.

122. UNRWA informed the Board that there was a solid professional base in the Department for conducting investigations. Also, once funding was secured, professional development training in forensic auditing would be conducted. UNRWA would carefully consider developing a fraud-prevention plan in conjunction with the United Nations.

D. Acknowledgements

123. The Board of Auditors wishes to express its appreciation for the cooperation and assistance extended to its staff by the Commissioner-General, senior officers of UNRWA and members of their staff. This cooperation and assistance was especially welcome in view of the fact that the audit had to be performed from Amman during an extremely difficult time as a result of the crisis in the Middle East.

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

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

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

27 June 2002

Annex

Follow-up on action taken on the recommendations of the Board of Auditors in its report for the biennium ended 31 December 1999^a

1. The Board has followed up on the actions taken by the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) to implement the Board's recommendations made in the context of its report for the biennium ended 31 December 1999. Table A.1 summarizes the status of implementation of all the previous recommendations, while table A.2 details specifically those recommendations not implemented and those recommendations under implementation that require further comment.
2. Out of a total of nine recommendations, five had been implemented and three were under implementation, while only one had not been implemented.

^a *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 5C (A/55/5/Add.3), chap. II.*

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

<i>Topic</i>	<i>Implemented</i>	<i>Under implementation</i>	<i>Not implemented</i>	<i>Total</i>
A. Financial issues				
Cash-flow statement	para. 19	-	-	1
Contingent liabilities	para. 21	-	-	1
Presentation of financial statements	para. 26	-	-	1
Format of income and expenditure statement	para. 28	-	-	1
Cash management	-	-	para. 41	1
Accounts receivable	-	para. 44	-	1
Subtotal				
Number	4	1	1	6
Percentage	100	0	0	100
B. Management issues				
Programme management	para. 34	-	-	1
Overpayments of allowance	-	para. 51	-	1
Asset management	-	para. 55	-	1
Subtotal				
Number	1	2	0	3
Percentage	20	60	20	100
Total				
Number	5	3	1	9
Percentage	56	33	11	100

Table A.2

Details on previous recommendations under implementation or not implemented for the biennium 1998-1999

<i>Management</i>			<i>Comments of the Board</i>
<i>Area of concern</i>	<i>Recommendation</i>	<i>Specific management action/comments as at 30 April 2002</i>	
Cash management, para. 41	The Board recommends that the Administration review its policy on the pre-financing of donor-specified projects in view of the adverse effect on the cash flow of the Agency. Also, the Administration should recover \$24.2 million outstanding from donors and reimburse the regular budget funds.	There is no written policy on pre-financing of donor-specified projects. In the interest of speedy implementation and quick receipt of project funds from a donor, there have been instances, on an ad hoc basis, where the allotment of funds was advanced in order to initiate preliminary project implementation actions, e.g., preparation of tender documents, etc. and meet the initial funding requirements of a project. This practice was limited on paper only, it never really had any impact on the Agency's resources. Also, it is worth noting that some donors (one or two at the most) insist on conditioning their project funding on a reimbursement basis. However, at any point in time, total project allotments never exceeded total project funds received, and therefore, such a practice, if needed, never had an impact on the Agency's cash-flow situation.	Not implemented. Addressed in paras. 46-53 of the present report.
Accounts receivable, para. 44	The Board recommends that the Agency strengthen its efforts to recover the outstanding tax reimbursement of \$23.72 million and that it make further appeals to two Governments to accept the tax-exempt status of the Agency.	The Agency is vigorously pursuing this matter on an ongoing basis.	Under implementation. Refer to paras. 39-45 of the present report.
Allowances, para. 51	The Board recommends that the Administration recover all overpayments relating to extended monthly evacuation allowances and education grants. The Board also recommends that the Administration review the various administrative instructions relating to extended monthly evacuation allowances and education grants to remove ambiguities in their interpretation and application.	Out of the initial 14 cases, 9 have fully settled, 2 are under appeal and 3 are being processed by the Legal Office.	Under implementation. The Board will continue to keep this matter under review. (An amount of \$46,092 was recovered, while \$253,000 remained outstanding.)

<i>Management</i>			<i>Comments of the Board</i>
<i>Area of concern</i>	<i>Recommendation</i>	<i>Specific management action/comments as at 30 April 2002</i>	
Asset management, para. 55	The Board recommends that the Administration develop and implement a computerized asset management system in order to better manage and control its non-expendable property items.	Acquisition of the fixed-asset module with the new financial management system during the biennium 2000-2001.	Under implementation. Refer to paras. 31-34 of the present report.

Chapter III

Audit opinion

We have audited the accompanying financial statements numbered 1 to 7 and the supporting notes of the United Nations Relief and Works Agency for Palestine Refugees in the Near East for the financial period ended 31 December 2001. The financial statements are the responsibility of the Commissioner-General. Our responsibility is to express an opinion on the financial statements based on our audit.

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

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

Further, in our opinion, the transactions of the United Nations Relief and Works Agency for Palestine Refugees in the Near East, which we have tested as part of our audit, have, in all significant respects, been in accordance with the Financial Regulations and Rules and legislative authority.

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

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

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

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

27 June 2002

Chapter IV

Certification of the financial statements

10 March 2002

Pursuant to financial regulations 11.4 and 12.1, I have the honour to submit the accounts of the United Nations Relief and Works Agency for Palestine Refugees in the Near East for the biennium ended 31 December 2001.

I certify that all transactions have been properly recorded in the accounting records and have been properly reflected in the Agency's financial accounts and appended statements, which I hereby certify as correct.

(*Signed*) **Ramadan Al Omari**
Comptroller
UNRWA Headquarters (Gaza)

Chapter V

Financial statements for the biennium ended 31 December 2001

Notes to the financial statements

Note 1

Objectives of the United Nations Relief and Works Agency for Palestine Refugees in the Near East

The mission of the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) is to provide services to and to promote the human resources development of the Palestine refugees through the provision of education, health, relief assistance, social services, income-generating activities, infrastructure development projects and related activities within its area of operations.

Note 2

Summary of significant accounting policies

Basis of presentation

(a) The financial statements are prepared in accordance with generally accepted accounting principles, the United Nations system accounting standards and international accounting standards. The accounts of the Agency are maintained on the accrual basis of accounting with regard to all income and expenditure in accordance with article 10.2 of the Agency's amended financial regulations of June 2001.

(b) The fundamental accounting assumptions of going concern, consistency and accrual are followed in the financial statement presentation.

(c) The Agency operates a system of fund accounting by which it maintains separate accounts for the regular budget, the project funds and the Provident Fund. The Agency's system of fund accounting provides a full identification of income and expenditure by purpose and the complete separation of the assets and liabilities of each fund. Contributions or allocations to funds other than the regular budget are assigned individual prefixes, which are maintained as distinct financial and accounting entities, with separate double-entry groups of accounts.

(d) The Agency's financial period consists of two consecutive calendar years. An interim closure of accounts is carried out at the end of the first year and a final closure at the end of the second year.

(e) The financial statements are prepared under the historical cost convention.

Foreign currency translation

(f) The accounts of the Agency are maintained in United States dollars. Transactions in other currencies are translated into United States dollars using the United Nations operational rate of exchange prevailing at the time of the transaction. At the end of a financial period, assets and liabilities in other currencies are reflected in United States dollars at the rate of exchange applicable at 1 January of the following year. Gains or losses on conversion of currencies between the market rates and United Nations operational rates of exchange are treated as an addition to or deduction from income.

Income recognition

(g) Cash contributions are recorded as income on the basis of confirmed donor pledges to pay contributions at specified times during the current financial period. Pledges in respect of in-kind donations and non-regular activities have not been accrued. Using the donor's valuation, contributions in kind are recorded as income only when they are received by the Agency.

(h) At the request of donors, contributions received in the current period for a future financial period are treated as income received in advance in the accounting records.

(i) Interest income on bank deposits, income derived from the sale of used vehicles and equipment, the share of profits on insurance policies, income from production units and other sundry income are treated as miscellaneous income.

Expenditure

(j) Total expenditures reported in the financial statements include disbursements, unliquidated obligations made against the allocation for the financial period and carry-forwards.

(k) In accordance with article 10.4 of the Agency's financial regulations, expenditure on acquisition, construction or capital improvements of land and buildings is capitalized.

(l) Costs incurred on the purchase of expendable supplies and the acquisition of non-expendable equipment, furniture and motor vehicles are charged to expenditure on purchase. Therefore, the values of non-expendable property including inventories are not included in the assets of the Agency. Although the Agency's non-expendable property is not treated as an asset, memorandum accounts and strict controls over assets are maintained. The asset records are maintained on a historical cost basis.

Note 3

End-of-service benefits

A provision is made in the budget for separation payments to staff members who leave the Agency during a financial period. However, reserves have not been established for separation costs for future years. Hence, these payments would be expected to be met from future income and operating reserves. In the event of a closing down of UNRWA, the accumulated termination benefits for area staff as at 31 December 2001 is estimated at around 143.6 million based on current costs as well as rules and regulations.

Note 4

United Nations Joint Staff Pension Fund

UNRWA is a member organization of the United Nations Joint Staff Pension Fund, which was established by the General Assembly to provide retirement, death, disability and related benefits. The Pension Fund is a funded defined-benefit plan. It is mandatory for the Agency's internationally recruited staff members to join the Fund. The financial obligation of UNRWA to the Fund consists of its mandated contribution at the rate established by the Assembly together with its share of any

actuarial deficiency payments that might become payable pursuant to article 26 of the Regulations of the Fund. Such deficiency payments are payable only if and when the Assembly has invoked the provision of article 26, following a determination that there is a requirement for deficiency payments based on an assessment of the actuarial sufficiency of the Fund as at the valuation date. At the time of the present report, the Assembly had not invoked that provision. The Agency's liability towards the Fund had been fully met as at 31 December 2001.

Notes applicable to regular budget funds

Note 5

Income from other sources

This income represents miscellaneous contributions received in cash and in kind from individuals, charitable institutions, social bodies and merchants.

Note 6

Miscellaneous income

Miscellaneous income comprises income derived from the following (in United States dollars):

<i>1998-1999</i>	<i>Miscellaneous income</i>	<i>2000-2001</i>
1 652 576	Bank interest	2 914 783
54 990	Income/(loss) from production units	(148 907)
108 320	Sale of used vehicles and equipment	37 746
47 868	Share of profit on insurance policies	15 843
389 303	Sundries	358 965
2 253 057	Total	3 178 430

Note 7

Accounts receivable

Accounts receivable reported in statement 2 include the following items (in United States dollars):

<i>1999</i>	<i>Accounts receivable</i>	<i>2001</i>
-	Contributions receivable ^a	23 417 420
1 968 665	Personal account of staff members	1 405 432
53 203	Refundable utility deposits	69 143
19 364 862	Value-added tax due from the Palestinian Authority	19 783 246
4 175 947	Customs and port charges	7 218 568
976 046	Claims against other Governments	1 311 639
12 234 390	Claims filed against Governments	12 242 297
332 170	Unfiled claims against Governments	341 929
2 596 962	Miscellaneous claims and receivables	2 668 271
41 702 245	Subtotal	68 457 945
(17 834 776)	Less: Provision for uncollectable amounts	(20 704 369)
23 867 469	Total	47 753 576

^a Contributions receivable represent confirmed pledges outstanding from donors towards regular budget activities for the biennium 2000-2001 as at 31 December 2001, as reflected in appendix 3. A total of \$18,582,661 had been received by the reporting date. No provisions have been made for the outstanding amount.

Note 8

Production unit inventory

The Agency has three self-supporting production units. These are the Embroidery Centre, the Carpentry Unit and the Contracting Section, all of which are located in Gaza. Up to 1987, those units were part of the General Fund. As from 1988 they have been set up as separate units to be governed by a new set of instructions for effective management control and performance assessment. Therefore, as an exception to the Agency's accounting policies, inventories of these production units are reported at cost under assets in the financial statements, as shown below (in United States dollars):

<i>1999</i>	<i>Production unit inventory</i>	<i>2001</i>
315 458	Raw material	319 047
37 663	Work in progress	70 258
1 662 430	Finished goods	1 695 873
2 015 551	Total	2 085 178

The approximate value of the Agency's inventories as at 31 December 2001, based on historical cost, amounted to \$10.0 million (1999 — \$11.9 million).

Note 9**Land and buildings**

The historical cost of land and buildings, which are capitalized, comprise the following (in United States dollars):

<i>1999</i>	<i>Land and buildings</i>	<i>2001</i>
219 049	Land	219 049
260 191 477	Buildings and structures	275 406 869
38 264 752	Refugee shelters	41 419 396
298 675 278	Total	317 045 314

Construction work in progress as at 31 December 2001 amounting to \$7,065,038 has been included in the above figures. As a result of introducing a new chart of accounts, this amount will be disclosed separately in the accounts for the next biennium.

Note 10**Area Staff Provident Fund**

The amount due (to)/from the Area Staff Provident Fund consists of the following (in United States dollars):

<i>1999</i>	<i>Fund</i>	<i>2001</i>
2 884 749	Main Provident Fund	633 675
10 060	Post-Employment Fund	-
(110 705)	Due to Austrian Schilling Fund	(128 039)
2 784 104	Total	505 636

Note 11**Other fixed assets**

The historical costs of other fixed assets, which are expended at the time of purchase, comprise the following (in United States dollars):

<i>1999</i>	<i>Other fixed assets</i>	<i>2001</i>
15 890 091	Vehicles	16 921 283
1 859 752	Vehicles surveyed	1 778 109
47 144 051	Equipment	46 914 647
183 895	Equipment surveyed	143 970
15 087	Missing equipment	15 087
-	Loss of vehicles not attributed to emergencies	22 186
65 092 876	Total	65 795 282

Note 12
Accounts payable

Accounts payable include (in United States dollars):

<i>1999</i>	<i>Accounts payable</i>	<i>2001</i>
8 412 453	Accounts payable	6 565 203
381 340	Deposits received	379 038
487 534	Funds held for other organizations ^a	8 283 597
785 226	Unpaid cheques, salaries, wages, etc.	1 887 501
10 066 553	Total	17 115 339

^a Includes short-term investments amounting to \$6.9 million made on behalf of the Microfinance and Microenterprise Programme's surplus funds by the Agency.

Note 13
Provision for unliquidated obligations/goods in transit

The provisions for unliquidated obligations and goods in transit are provisions made in the financial period but for which the goods or services have not yet been received.

Note 14
Provision for carry-forwards

The provision for carry-forwards is a provision for items budgeted in the financial period for which justification has been given that these items are charged to the current year's expenditure.

Note 15
Commitments and contingent liabilities

As at 31 December 2001, the Agency's annual commitments under lease/rental agreements executed with various parties amounted to \$1,210,335.

A number of personnel appeals that could involve payment of back wages and entitlements are pending with the respective Appeals Boards of the international and area staff as well as with the United Nations Administrative Tribunal in New York. The contingent liabilities on those appeals and commercial contracts amounted to approximately \$2,465,122 as at 31 December 2001.

Note 16
Reclassifications

Certain accounts in the financial period were reclassified or have been restated to comply with the Financial Regulations and recommendations made by the Board of Auditors and to improve the presentation of the financial statements.

Notes to the Microfinance and Microenterprise Programme financial statements

Note 1

Programme objectives

The Microfinance and Microenterprise Programme strives to maintain the best practices of the microfinance industry by adhering to the standards established for the industry by such institutions as the Consultative Group for Assistance to the Poor, the United States Agency for International Development, the Microfinance Network, the Calmeadow Foundation and Acción Internacional. The Programme attempts to achieve international standards of efficiency and outreach in a way that provides cost-effective services to clients in a sustainable manner. Though conditioned by the political and economic situation in the West Bank and Gaza where the Programme is focused, including protracted economic decline during the intifada, the Agency continues to pursue its objective of programme development and expansion.

Since June 1991, the UNRWA Microfinance and Microenterprise Programme in the West Bank and Gaza has helped promote small business development, create employment, improve the income of microenterprises and reduce poverty through the establishment of a number of targeted credit programmes aimed at small businesses, microenterprises and women. The Programme is organized around three revolving loan funds in Gaza and two in the West Bank. The programme supports businesses varying in size from microvending, employing just one or two individuals, to small industries, and aims to satisfy a variety of needs such as capital funding and working capital financing.

Note 2

Summary of significant accounting policies

(a) The accounts of the Programme are maintained on an accrual basis in respect of operating expenditure and on a cash basis for interest income.

(b) Capital inflows to the Programme are through: (i) donor contributions, which are channelled through the UNRWA accounts; and (ii) funds revolved through the repayment of loan instalments from borrowers. Contributions from donors to the Programme are first treated as income to UNRWA, and on disbursement to borrowers is treated as capital of the Programme. Accumulated capital of the Programme represents the total amount of these contributions from donors.

(c) The Programme's funds are disbursed to borrowers under three credit programme categories: small-scale enterprise credit, solidarity-group lending and microenterprise credit. The types of security required vary with the credit programme and generally include notarial deeds, post-dated cheques and loan guarantors. When loans are granted for the purchase of commercial vehicles, under a microenterprise credit, the security obtained is a mortgage on the vehicle.

(d) Surplus cash, if any, pending disbursement to borrowers is invested in short-term deposits with commercial banks of the Agency.

(e) The adequacy of provisions for loan losses is reviewed quarterly, and provisions are made according to the bad debt policy of the Programme, which was

revised by the Advisory Board in November 2001 to reflect the true status of its loan portfolio.

(f) The accounts of the Programme are maintained in United States dollars. Transactions in other currencies are translated into United States dollars using the United Nations operational rate of exchange prevailing at the time of the transaction. At the end of a financial period, on 31 December, assets and liabilities in other currencies are reflected in United States dollars at the rate of exchange applicable at 1 January. Gains or losses on the exchange of currencies are treated as an addition to or deduction from net income.

(g) The Programme's financial period consists of two consecutive calendar years. An interim closure of accounts is carried out at the end of the first year and a final closure at the end of the second year.

Note 3

Donor contribution

This amount reflects the Arab Gulf Fund for United Nations Development Organizations (AGFUND) donation for the Small and Microenterprise Training Programme for Gaza and a donor contribution for loans in the West Bank.

Note 4

Miscellaneous income

Miscellaneous income represents funds transferred from fee income held for training to cover staff costs of the Small and Microenterprise Training Unit (see note 10 below).

Note 5

Accounts receivable

Accounts receivable include loans outstanding from funds disbursed through both initial donor contributions (first-time loans) and from revolving loan funds. The provision for loan losses represents provisions made for doubtful loans under the revised bad debt policy, resulting in an increased provision of \$1,051,504 over the previous year.

Note 6

Short-term investments

Short-term investments comprise the Programme's surplus funds invested in banks.

Note 7

Accounts payable

Accounts payable include a sum of \$500,000 borrowed by the West Bank programme from the Gaza programme.

Note 8

Bills payable to the Agency

This represents the reimbursements due from the Programme to UNRWA in respect of operating expenditures incurred, which is billed every quarter.

Note 9

Agency contribution to the Programme

These amounts reflect the contribution made by UNRWA to the Programme at its inception. These have been classified as a liability pending a decision by UNRWA to recover them or to treat them as capital of the Programme.

Note 10

Funds held for training

This represents the balance remaining on the course fee charged on business and management training conducted for entrepreneurs and managers to cover future costs of the Small and Microenterprise Training Unit.

Note 11

Fund balance

The fund balance represents prize money and donations received from AGFUND earmarked for training activities.

Note 12

Prior-year adjustments

During the year, previous initial donor contributions (projects) were reclassified as belonging to the Microfinance and Microenterprise Programme, and therefore prior-year adjustments have been made to reflect this.

Notes to the Provident Fund financial statements

Note 1

The Fund

The Provident Fund is a benefit that applies to all area staff members and is the equivalent of a defined-contributions pension plan. The Fund, which was established in 1955, had 22,095 participants as at 31 December 2001. This figure does not include 892 separated staff members who still hold their credits with the Fund under the Fund's rules. The monthly contribution amount is based on a mandatory 7.5 per cent payroll deduction for each staff member plus the Agency's share of 15 per cent. Under the Provident Fund rules, staff members are allowed to make additional voluntary contributions up to a maximum of 50 per cent of monthly payroll. Provident Fund loans against staff credits for educational, medical and housing needs are granted to the members. These loans must be repaid within a period of 10 years. As at 31 December 2001, an amount of \$55,664,219 was outstanding as loans. All participants receive the lower of book or market value return on the Fund for the period of employment/membership in the Fund. The Fund is administered by the Provident Fund Secretariat jointly with the supervision and guidance provided by two committees, the Provident Fund Committee and the Investment Advisory Committee.

Note 2

Investment management and investments

The Fund employed seven investment managers, four for the global bond portfolio and three for the global equity portfolio. The approved guidelines for investments allowed for an asset allocation mix of 75 per cent for bonds and 25 per cent for equities. However, the actual asset allocation of the portfolio as at 31 December 2001 was 76 per cent bonds and 24 per cent equities. The custody of assets is with a global custodian, the Northern Trust Company. A securities lending programme is also administered by the Northern Trust Company under which the assets of the Fund are lent to approved borrowers for a short duration for a commission. The Northern Trust Company calculates the performance numbers for the Fund. The equity investment manager, Nicholas Applegate Capital Management in San Diego, was terminated in December 2001, and the portfolio managed by it was transferred equally to Gulf International Bank and Lombard Odier for management. The investments are valued, for the purpose of generating an income figure, at the lower of cost or market value on a portfolio basis. The value of investments at 31 December 2001 was \$787,789,329 for the dollar fund and \$128,039 for the Austrian schilling fund. The investment managers' valuation based on market value was \$788,797,402 for the dollar fund. Subsequent to the transfer of the members' balances to the dollar fund in July 1998, the investment management function of the Austrian schilling fund was delegated to the Treasurer of the Agency.

Note 3**Investment income**

Gross investment income for the biennium comprises the following (in United States dollars):

Interest from fixed-income securities	63 088 766
Dividends from equities	4 262 331
Realized capital gains/(losses)	(21 418 133)
Interest on short-term deposits	4 017 246
Total	49 950 210

Note 4**Foreign currency transaction**

The Provident Fund accounts are maintained in United States dollars. Transactions executed for liabilities and expenses in other currencies are translated to United States dollars at the United Nations operational rate of exchange prevailing at the time. Investment transactions executed in other currencies by the investment managers are translated to United States dollars at the market rates of exchange prevailing at the time.

Note 5**Administrative costs**

Direct expenses of the Provident Fund secretariat and expenses computed, based on time spent by staff, on the Provident Fund scheme at Headquarters and field offices are included under administrative costs. This expenditure has been allocated between general administration and loan scheme administration.

Note 6**Reserve for loan administration expenditure**

A reserve account has been established for the difference between the 1 per cent administration fee levied on Provident Fund loans and loan administration expenses to compensate for any future shortfalls.

Note 7**Contributions and fund balances**

The movement of funds and the resultant amount due from the Agency to the Provident Fund as at 31 December 2001 is given below (in United States dollars):

<i>Funding sources and applications</i>	
Continuing participants credits	(8 586 621)
Retirees credits	(29 689 972)
Separated participants credits	(3 550 758)
Investment income	(24 956 215)
Decrease in investment portfolio	68 775 890
Net funding sources	1 992 324
Increase in reserves and accounts payable	258 750
Applied to General Fund	(2 251 074)
Add: Amount due to General Fund on 1 January 2000	2 884 749
Amount due to Agency's General Fund at 31 December 2001	633 675

Note 8**Post-Employment Fund**

The assets of the Post-Employment Fund, which was established for teachers employed on contract basis, was merged with the main Provident Fund in March 2000.

Note 9**Subsequent events**

(a) A rebalancing activity was conducted in February 2002 to diversify Provident Fund risk and to benefit from the cheap prices of equities. This was executed by reallocating funds from the Baring and Fiduciary portfolios to all other bond and equity portfolios.

(b) The Agency's offices in Vienna were closed in January 2002. However, the Austrian schilling Provident Fund's investments will continue to remain with the Agency until they are withdrawn by the members.