

### Background

Indirect Support Costs (ISC) is defined as “all costs incurred by the Agency in support of the implementation of its non-programme budget activities that cannot be traced unequivocally to specific activities, project, or programmes. A standard ISC rate of 11 percent has been developed to recover ISC from the respective donors.” Budget Technical Instruction #22 (BTI), effective January 2017, defines the ISC, provides the principle for ISC recovery, the applicable standard ISC rate, procedures for charging and budgeting for ISC, guidance for calculation of the amount, and specifies accounting and use of ISC income. UNRWA Finance Technical Instructions (FTI), effective January 2012, section F.13 – Indirect support costs – V7.0 also states the purpose as well as responsibilities involved parties.

A standard rate of 11% has been set to recover ISC from the respective donors with the provision to lower or waive the standard rate on a case-by-case basis with approval of the Director of Finance.

### Objective and purpose of Audit

The audit aimed to assess whether the governance arrangements, risk management practices and controls for management of ISC are adequate and effective in line with relevant UNRWA rules and regulations as well as with donor agreements.

### What DIOS concluded

DIOS assessed the management of ISC focusing on collection and utilization as “Partially Satisfactory - Some Improvement Needed”, which means that “the assessed governance arrangements, risk management practices and

controls were adequately established and functioning well but need some improvements to provide reasonable assurance that the objectives of the audited entity/area should be achieved. Issues identified by the audit do not significantly affect the achievement of the objectives of the audited areas. Management action is recommended to ensure that identified risks are adequately mitigated”.

DIOS noted that different ISC rates were charged to donor grants despite uniform rate per relevant policy while the requests to waive 11% standard ISC rate were often submitted after donors had signed agreements. A total of 552 grants was in place the period from 1 January 2019 till 31 March 2021, 48% of these were Emergency Appeals (EA), 32% Projects (earmarked) and 20% unearmarked (PB relieving). 14 different ISC rates ranging from 0 to 15% were charged as shown below:

ISC rate breakdown							
Grant type	Grants	# of grants within ISC % range					
		0	> 0%-4%	> 4%-8%	> 8%-10%	11%	> 11%
GF: Cash (& in-kind) contribution (PB relieving)	113	22	2	12	6	68	3
Projects	174	49	2	24	13	83	3
EA (Emergency Appeals)	265	33	3	56	11	162	-
<b>Total</b>	<b>552</b>	<b>104</b>	<b>7</b>	<b>92</b>	<b>30</b>	<b>313</b>	<b>6</b>

Furthermore, BTI does not contain guidance on how the financial impact should be conducted as part of justification to waive or reduce ISC rate. Lastly there is a common perception that ISC allocation takes place arbitrarily at HQ level because the existing policy for utilization of ISC has not been clearly promulgated and communicated.

On the other hand, project budgets were created in the Grant Management and issued in accordance with the guidelines, and applicable ISC is charged as expense to donor project budgets as required by the BTI and accounted for accordingly.

### What DIOS recommended

- 1 Finance department, in consultation with DER, should enhance the BTI by including guidelines for standard practice in place for lower ISC rate (such as donor initiated grants and donors with reduced rates under existing agreements), and including accountability measures for unjustified post facto approval request..
- 2 Finance Department should enhance BTI to include the requirement to conduct and present the financial impact analysis as part of justification to waive or reduce ISC rate to guide

informed decision making as to whether non-programme budget activities constitute a financial burden to the programme budget.

- 3 Finance Department should enhance the BTI and the FTI on "Use of ISC" to explain the current policy for ISC utilization and clearly communicate it within the agency to correct misperception and enhance transparency in the utilization of ISC.

### What management is doing to address DIOS recommendations

Management has already taken action to implement the recommendations, including additional measures to account for post facto approvals, revised guidance on financial impact analysis against other factors, and clarification on utilization of ISC for further communication per promulgation of BTI revision.

## Methodology, Approach and Disclosure

DIOS conducted an audit of the management of Indirect Support Costs (ISC), focusing on collection and utilization. The audit aimed to assess whether the governance arrangements, risk management practices and controls for management of ISC are adequate and effective in line with relevant UNRWA rules and regulations as well as with donor agreements.

The audit covered charging (collection) of the applicable ISC to donor funded projects, budgeting and accounting collection, and utilization, and accounting of ISC income for the period from 1 January 2019, till 31 March 2021.

The audit approach included enquiries and discussions with relevant staff, review of control processes and documents, analysis and examination of selected samples and other procedures deemed necessary. The fieldwork was conducted from beginning of July to end of September 2021.

The audit was conducted in accordance with DIOS standards, which are designed to conform to the International Standards for the Professional Practice of Internal Auditing. It was completed in conformity with the approved work plan and took into consideration the risk assessment exercise conducted prior to the audit.

Pursuant to OD14, this summary of findings and recommendations including management action taken to address recommendations is made publicly available on the DIOS internet page upon issuance of the report on 9 February 2022.