


February 2013

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## FINANCE COMMITTEE

**Hundred and Forty-eighth Session**

**Rome, 18 - 22 March 2013**

**FAO Audit Committee - 2012 Annual Report to the Director-General**

Queries on the substantive content of this document may be addressed to:

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### EXECUTIVE SUMMARY

- The Director-General is pleased to provide the Finance Committee with the Audit Committee's 2012 Annual Report to the Director-General, together with the Director-General's comments, as foreseen in the Audit Committee's Terms of Reference (MS 146 – App. C). The Terms of Reference also require that the Committee's Chairperson or another member, as decided by the Committee, will be invited to present the Annual Report to the Finance Committee. The report:
  - concludes positively on the operation of the Office of the Inspector General (OIG) and its coordination with other oversight functions.
  - summarizes the Committee's advice regarding internal control, risk management and governance based on its deliberations during the year.
  
- The Director-General concurs with the Committee on:
  - the importance of completing and institutionalizing results-based planning and monitoring, enterprise risk management, and performance reporting, supported by an accountability and internal control framework that helps integrate and mutually reinforce these elements. Further information on this will be presented in the Final Management Report on IPA Implementation and the FAO Reform Process (C 2013/26);
  - careful risk management of the planned steps in 2013 for deployment and post-deployment of the Global Resource Management System and International Public Sector Accounting Standards readiness. Further information on this will be presented in the Progress Report on the GRMS (FC 148/13);
  - completing FAO's first vendor sanctioning guidelines as early as possible in 2013. The Legal and Procurement Services, with OIG support, have been requested to give this priority; and
  - the need to continuously aim at reducing the time to close outstanding audit recommendations. Management give priority to closing the long outstanding internal audit recommendations presented in OIG's 2012 annual report.

### GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is invited to take note of the FAO Audit Committee's Annual Report for 2012.

### Draft Advice

- **The Finance Committee took note of the FAO Audit Committee's Annual Report for 2012.**

## 1. INTRODUCTION

1.1 As an independent advisory expert body fully comprising external members, the FAO Audit Committee (the Committee) assists the Director General in fulfilling his oversight and governance responsibilities. The Committee helps ensure that the Director-General receives independent and objective assurance on the effectiveness of the internal audit, inspection and investigation functions, and provides advice on the system of internal control, risk management and governance. It accomplishes this, amongst others, by considering the work of the Office of the Inspector General (OIG), the other FAO oversight functions (Evaluation and External Audit) and management presentations and action on audit recommendations and investigation reports.

1.2 According to the Committee's Terms of Reference (Annex 1), the Director-General is to provide a copy of the Committee's annual report to the Finance Committee, together with his/her comments thereon, if any.

1.3 This Tenth Annual Report of the Committee provides an overview of the Committee's discussions and recommendations during 2012. The Committee normally meets three times per year, but met four times in 2012. The third meeting for 2011, in FAO's Regional Office for Asia and the Pacific, was postponed until January 2012 due to the Bangkok flooding in late 2011, and its deliberations were included in the 2011 Annual Report. This report covers deliberations in the other three meetings in 2012.

1.4 The composition of the Committee during 2012 is provided in Annex 2.

## 2. FUNCTIONING OF THE COMMITTEE

2.1 During the reporting period, the Committee convened in March, July and December 2012 at FAO Headquarters, meeting over a two day period each time. Full membership of the Committee was maintained throughout the year, all members were present for two meetings and for the third meeting four members were present but the other member was able to participate partially via videoconference.

2.2 The Committee records its appreciation for the effective secretariat services provided by OIG during the year, in support of the scheduled meetings as well as between sessions.

2.3 The Committee is pleased to note a continuing good engagement with the External Auditor. The Committee was briefed on the external audit plans, audit progress and results, at its July and December 2012 meetings.

2.4 The Director General has designated the Deputy Director General - Operations as his focal point to obtain feedback on the key issues raised during its scheduled meetings and to be briefed on the results of the Committee's deliberations at the conclusion of the meetings. The Committee met with the focal point or his alternate at each meeting. During such briefings, the Committee drew attention to a number of matters, key amongst which are discussed in this report.

2.5 The Committee regularly reviewed its functions and considers that it has discharged its duties in accordance with its current Terms of Reference.

2.6 Proposed revisions to these Terms of Reference were endorsed by the Director General and submitted to the Finance Committee at its 147th session in late 2012. The proposed changes include:

- a) update the Terms of Reference for changes already implemented on the membership under the Immediate Plan of Action;
- b) increase the emphasis in the Terms of Reference on the Committee's role beyond the current focus on monitoring the activities of OIG. Other roles, mentioned briefly in the current Terms of Reference but equally value-adding for the Organization, are to provide advice on financial reporting, internal control arrangements, and risk management processes; and
- c) more fully document, in line with a current good practices benchmark for UN and other multilateral organizations, the established operating mode of the Committee.

2.7 The Audit Committee concurs with revisions proposed by the Finance Committee at its 147th session and looks forward to the final version of the updated Terms of Reference being endorsed in Spring 2013.

### **3. EFFECTIVENESS OF OIG FUNCTIONS**

3.1 An important part of the Committee's mandate is to provide independent and objective assurance on the effectiveness of the internal audit, inspection and investigation functions. Based on the information provided by OIG, the results of the external quality assurance review of the internal audit function in 2012, and the briefings provided by FAO management and the External Auditor, the Committee considers that OIG is delivering its services adequately and effectively, including implementing a process of continuing improvement. Areas that were given particular attention by the Committee in 2012 are summarized below.

3.2 Internal Audit Quality Assurance Review: The Committee welcomed the confirmation, from the 2012 external quality assurance review by BDO Consulting Finland, that OIG had attained full compliance with the International Standards for the Professional Practice of Internal Auditing (the International Standards). Following the review, OIG reported to the Committee on the status of implementation of recommendations made from the earlier 2011 preliminary review and the 2012 full review, and advised that by end of 2012 it had fully implemented these.

3.3 OIG Charter Update: The Committee welcomed the approval of the Director General and endorsement of the Finance Committee of an update of OIG's Charter to add definitions of the assurance and advisory services that OIG conducts as part of its internal audit function, and other information on this function as required by the International Standards and reflect some modifications to the OIG report disclosure policy. The updated Charter takes effect from January 1, 2013 and closes related recommendations from the 2011 and 2012 quality assurance reviews.

3.4 Risk-Based Audit Assurance: The Committee notes for the 2012-2013 biennium, the OIG based their audit strategy on a risk-based audit plan (RBAP) that took into account inputs from management. The Plan, which was endorsed by the Committee and Director General in early 2012, continued to focus on addressing the highest risks of the Organization. In this regard the Committee notes with satisfaction that by the end of 2012, the OIG had reported completion of assignments that covered 30 of the 42 high risks included in the 2012-2013 RBAP, as well as 39 medium risks. Key areas of focus in 2012 included ongoing assessments of the Organization's decentralized field network; the Global Resource Management System (GRMS) and International Public Sector Accounting Standards (IPSAS) implementation; Information Technology project management; decentralization and integration of emergency operations to the field offices; professional recruitment; monitoring over field procurement and letters of agreement; the Technical Cooperation Programme and audit recommendation follow-up. This risk-based approach helps ensure that OIG's assurance and advice are focussed on important areas throughout the Organization in a timely fashion, and the Committee finds this to be evidenced by the topics reported on by OIG during the year.

3.5 The Committee also notes with satisfaction that OIG and the External Auditor met regularly during the year to coordinate their respective activities to maximise synergy of audit work, and that a joint OIG and Office of Evaluation staff event was held in November 2012 which identified areas, and related actions for the coming year, where the two offices could collaborate more effectively. Also, in response to a previous recommendation of the Committee, OIG took a number of steps to more clearly distinguish its assurance and advisory audit work.

3.6 Investigative Functions: The Committee welcomed the strengthening of OIG's forensic capacity in terms of new software tools and the addition of a P3 level Forensic Investigator. It also appreciates the efforts made in 2012 by the Investigation Unit to manage its caseload such that reported open matters at the end of the year are lower than recent years, and an average time for closing of a complaint of 123 days, within OIG's target of closing all complaints within six months, was achieved.

3.7 Whistleblower Protection Policy: In its 2011 Annual Report, the Committee recommended that the Organization consider whether the initial review of complaints of retaliation, as defined under the Whistleblower Protection Policy and currently handled by OIG, should be transferred to a competent party elsewhere in the Organization similar to practice elsewhere in the UN System. The Committee noted that this had been carefully considered by the Finance Committee and the Committee on Constitutional and Legal Matters. While the Governing Bodies concluded that it would be premature to transfer OIG's responsibility for preliminary review of complaints under the Policy at this time, the Committee welcomed their agreement that this matter should be kept under review. The Committee will monitor this with OIG going forward.

3.8 OIG Report Disclosure: In April 2011 the FAO Council approved an OIG report disclosure policy that makes available to Permanent Representatives or their designates, for viewing in OIG's premises, internal audit reports and reports of lessons learned from investigations. As there were no requests nor instances of redaction or withholding of reports by OIG in 2012, there was no requirement for review of such instances by the Audit Committee. The Committee notes that from 2013, the option for viewing reports via a secure internet connection will be implemented, which will facilitate requests in future.

3.9 OIG staffing: The Committee notes that, during 2012, OIG came close to having a full complement of professional staff but experienced some further vacancies – a pattern not unusual in the Committee members' experience. It welcomed OIG's efforts to fill vacancies as quickly as possible within the applicable Organizational policies, with staff with appropriate qualifications and experience and with due attention to gender, geographic and language diversity. It also noted that OIG used qualified and experienced consultants to ensure it delivered on its mandate.

#### **4. ADVICE ON THE SYSTEM OF INTERNAL CONTROL, RISK MANAGEMENT AND GOVERNANCE**

4.1 As part of its mandate the Committee provides advice on the system of internal control, risk management and governance. It does so drawing on the results of internal and external audit work and management presentations. During 2012 it focussed its attention on progress with developing FAO's overall accountability and internal control framework, as articulated in an OIG report issued early in the year; on the implementation of the GRMS including IPSAS preparations; on progress with implementing a stronger set of measures to promote integrity by suppliers, partner organizations and other third parties in their work with FAO; on the measures being taken to control FAO operations in Somalia which represent a particular challenge due to the extreme security risks in parts of the country and the multiple commitments which FAO has engaged to prevent diversion of funds to proscribed entities; and the status of past high priority internal audit recommendations.

4.2 FAO Transformational Changes: The Committee reiterates the importance completing and/or fully institutionalizing key initiatives started under the Immediate Plan of Action such as Results-Based Management, Enterprise Risk Management and the Performance Evaluation Management System, so that intended benefits are obtained and maintained. Enterprise Risk Management in particular needs to be reinvigorated. These are components of a strengthened accountability and internal control framework essential to support the further transformational changes sought by the new Director General. The Committee also reiterates the importance of a well articulated and communicated accountability and internal control framework document, tailored to the further changes initiated in 2012 in FAO's strategic framework, organizational structure and further decentralization of responsibilities to field locations. Such a document can help ensure that results planning, risk management and performance review are integrated and mutually reinforcing, and well understood by the staff who must breathe life into these elements, as well as external stakeholders.

4.3 GRMS Programme, including IPSAS: The GRMS programme aims to deliver a major improvement in FAO's financial information and management, through upgrades to the existing resource management system and its deployment beyond Headquarters and Regional Offices to its

extensive network of other decentralized offices. This will also support the implementation of IPSAS compliant financial reporting. During 2012 the Committee received regular briefings from the GRMS Programme staff on progress, and from OIG and the External Auditor on their reviews. The Committee is cautiously optimistic regarding successful implementation and obtaining IPSAS compliant financial statements by the new date of 2014, agreed by the Governing Bodies following the delays the project experienced from 2007-2012. The Committee welcomed the adjustment to the IPSAS timetable to respond to OIG's audit report early in the year, and good progress has been reported on system development and the first stages of deployment. The Committee notes that the Organization will confront the greatest risks when it begins system deployment to field offices starting in February 2013. It is critical that these risks are managed timely and efficiently to ensure the project meets its targets. The Committee is satisfied with OIG plans to devote close attention in 2013 to the deployment and further upgrades of the system in the first semester and to post deployment activities in the second semester.

4.4 The Committee welcomes plans by the external auditor to review IPSAS policies and guidance notes as soon as possible in early 2013, and, in view of the retendering of the external audit engagement for 2014 and later, it notes the importance of engaging on the changeover to IPSAS with the incoming external auditor, if the retendering results in a change in auditor.

4.5 Vendor Sanctioning: In its 2011 Annual Report the Committee encouraged management to conclude as soon as possible measures to implement, appropriate to the Organization's procurement methodology, the Model Policy Framework for Agencies of the UN System to Consider for Vendor Sanctions Procedures. The Committee notes that OIG and FAO's Procurement and Legal Services have collaborated during 2012 in drafting guidelines on the Organization's response when it is determined that vendors (suppliers, partners and others) have engaged in improper activities during tenders or in the course of contract implementation. The Committee was advised that these guidelines were at an advanced stage at the end of 2012 and, once finalized, will be referenced in vendor bidding documents and contracts, along with anti-corruption and right to audit vendor records clauses. The Committee recommends that management give this priority with a view to concluding these steps as soon as possible in early 2013.

4.6 Somalia Programme: The Committee was briefed by OIG on the results of its work in 2012 to support FAO's programme in Somalia. The Cash for Work projects in particular are pioneering how to deliver in the extreme security situations prevailing in parts of the country. The Committee noted that, towards the end of 2012, OIG was fully dedicating an investigator to review allegations and operational indicators of possible funds diversion. The Committee was informed of the evolution in control measures on the programme, and stresses that although management is responding well to the risks, especially to the Cash for Work projects, there may be a limit as to how effectively these risks can be managed and accordingly to how effective investigations and audits can be in supporting management to control the risks. It appreciates that management is keeping under continuous review the acceptability of the risk, and welcomes that donors are now being regularly briefed on this.

4.7 The results from the investigations of non-governmental organizations and suppliers engaged for the Somalia programme confirm the timeliness of a formal vendor sanction policy. The investigation activity and results for Somalia will help define this policy and related procedures.

4.8 OIG Recommendations: The Committee appreciated the implementation in 2012 of its recommended change in the definition of "long outstanding" for analyzing audit recommendations from 36 months to 24 months. It noted that despite this change, the number of outstanding "high risk" recommendations at the end of 2012, as reported in OIG's annual report, had not significantly increased. Nonetheless the Committee is concerned that progress by management in implementing some long outstanding high risk recommendations, reconfirmed by management as still being relevant, including business continuity and disaster recovery policies and plans, has not proceeded as quickly as warranted given the nature of the risks they are mitigating. The Committee encourages management to bring activities to address these to a close as soon as possible, and in general to continue efforts to reduce the time to close internal audit recommendations.

4.9 The Audit Committee also reiterates its advice for management responses on high risk long outstanding recommendations to accompany OIG's annual report, to clearly inform the Governing Bodies on their status.

## **5. ACKNOWLEDGEMENT**

5.1 The Committee acknowledges the good cooperation and assistance received from Management, from the Inspector General and his staff, other FAO staff and the External Auditor who provided information briefings during its 2012 meetings.

## APPENDIX C

### FAO's AUDIT COMMITTEE

#### 1. Introduction

The Committee operates as an advisory panel to the Director-General and to the Office of the Inspector General (AUD). Its aim is to assist the Organization in gaining house-wide acceptance of the importance and value of the internal audit, inspection and investigation functions and provide the Director-General with assurance that these functions are operating effectively and efficiently. The Committee will:

- (i) appraise the adequacy and effectiveness of the internal audit services and its strategies, priorities and work plans and suggest potential audit areas to address the Organization's risks;
- (ii) review progress in the implementation of AUD's action plans which have been agreed upon; and
- (iii) take note of the reports of the External Auditor and monitor timely follow-up of his/her recommendations.

#### 2. Terms of Reference

The Committee has the following responsibilities:

- (a) ensure the independent role of the Office of the Inspector General (AUD);
- (b) review and provide advice on the biennial work plans of AUD in the areas of audit and inspection;
- (c) review significant risks facing the Organization;
- (d) assess the effectiveness and adequacy of internal audit coverage with due regard to external audit coverage, to ensure that emphasis is placed on high-risk areas;
- (e) review the reports of AUD and the External Auditor (except for reports specifically requested by donors), assess the implications of their findings on existing policies, systems and procedures and actively oversee and monitor the timely implementation of the audit recommendations;
- (f) satisfy itself that AUD adheres to the international internal auditing standards adopted by the heads of audit of the United Nations, the Specialized Agencies as well as by the World Bank and other entities within the UN system;
- (g) review investigation findings of presumptive or actual mismanagement, irregularities and fraud, and monitor follow-up responsibilities;
- (h) review the AUD annual activity report to the Director-General subsequently provided to the Finance Committee;
- (i) review the performance and effectiveness of AUD, ensuring consistency with approved plans and the Charter of the Office of the Inspector General;
- (j) satisfy itself that the resources available for AUD are sufficient to meet the Organization's needs;
- (k) provide advice to the Director-General and the Inspector General as it deems appropriate; and



3. Composition of Committee

The Committee consists of five external members and a Secretary ex-officio. All members and the secretary are appointed by the Director-General. Members are selected on the basis of their qualifications as senior audit and/or investigation professionals. The Committee elects its own Chairperson. The Inspector General will provide secretariat services to the Committee.

4. Term of Office

Members serve for a two-year period, which may be renewed at the discretion of the Director-General for one or more years.

5. Meetings

(i) At the discretion of the Chairperson, the Committee may meet three to four times each year. Additional meetings may be called by the Chairperson if deemed appropriate.

(ii) The Inspector General has the right to request the Chairperson of the Committee to convene a meeting if necessary.

(iii) The presence of all five members is expected at each meeting but meetings can take place with a quorum of three members. The Secretary to the meeting (Inspector General) will have no voting rights.

6. Reporting and Authority

The Committee reports to the Director-General and all reports of the Committee will be addressed to him. The Director-General will provide a copy of the Committee's annual report to the Finance Committee, together with the Director-General's comments thereon, if any. The Chairperson or another member, as decided by the Committee, will be invited to the Finance Committee session to present the Committee's annual report. The Committee will have the authority to:

(i) obtain all necessary information and consult directly with the Inspector General and his/her staff;

(ii) access all reports and working papers produced by AUD;

(iii) seek any information it requires from any staff member and require all staff members to cooperate with any request made by the Committee;

(iv) obtain independent professional advice and secure the attendance of outside persons with relevant experience and expertise if considered necessary.

## COMPOSITION OF THE COMMITTEE

1. Following a recommendation of the former External Auditor and in accordance with FAO's commitment to the 100th Session of the Finance Committee, the Director-General established the FAO Audit Committee in April 2003. From inception until the end of 2007, the Committee had a combination of internal and external members. In January 2008, its membership became entirely external. The Committee's composition and terms of reference are set out in Manual Section 146 App. C.
2. In accordance with the Immediate Plan of Action (IPA) for FAO Renewal (2009-11), adopted by the Conference at its 35th (Special) Session, "the Audit Committee (a) will be appointed by the Director-General and have a membership which is fully external agreed by the Council on the recommendation of the Director-General and Finance Committee" (IPA action 2.92). The first appointment under this system was made in 2010.
3. The Committee's 2012 composition was as follows:

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|------------------------|--|
| Members:               | Mr E. Ouko (Chairman until June 2012)    |
|                        | Mr C. Andreasen (Chairman from May 2012) |
|                        | Ms C Dittmeier (from June 2012)          |
|                        | Mr A. Khan                               |
|                        | Ms F. Ndiaye                             |
|                        | Mr S. Zimmermann                         |
| Secretary (ex-officio) | Inspector General                        |