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Продовольственная и сельскохозяйственная организация Объединенных Наций

Organización de las Naciones Unidas para la Alimentación y la Agricultura

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# FINANCE COMMITTEE

| Hundred and Fifty-first Session |
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| **Rome, 11 - 15 November 2013** |
| **Programme of Work of the External Auditor** |

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## EXECUTIVE SUMMARY

- This report is intended to provide information to the FAO Finance Committee on the status of the External Auditor's programme of work for the Biennium 2012-2013.
- The External Auditor carried out its audit in accordance with its risk-based audit plan. It covered nine financial and management reviews in Headquarters and the audit of five decentralized offices. It has issued 14 Management Letters to FAO Management containing the results of the audit.
- The result of the audit on six areas are discussed in this report. These areas are: 1) Review of Accountability Framework; 2) Assessment of IPSAS Implementation; 3) Review of IPSAS Accounting Policies; 4) Audit of Interim Financial Statements; 5) Review of Project Accounting; and 6)Review of Investment Operations.

## GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The External Auditor seeks to inform the Finance Committee of the current programme of work of the External Auditor.

### Draft Advice

- **The Committee took note of the status of work of the External Auditor and appreciated the comprehensiveness and quality of the audit work.**

## A. Introduction

1. This report is intended to provide information to the Finance Committee of the Food and Agriculture Organization of the United Nations (FAO) on the current status of the External Auditor's programme of work for the Biennium 2012-2013.

## B. Scope of Audit

2. The scope of work of the External Auditor is governed by the provisions of Regulations XII of the FAO Financial Regulations and the additional terms of reference governing the external audit of FAO.

3. Specifically, the External Auditor shall perform such audit of the accounts of the FAO, including all Trust Funds and special accounts, as deemed necessary:

- that the financial statements are in accord with the books and records of the Organization;
- that the financial transactions reflected in the statements have been in accordance with the FAO rules and regulations, the budgetary provisions, and other applicable directives;
- that the securities and moneys on deposit and on hand have been verified by the certificates received directly from the Organization's depositaries or by actual count;
- that the internal controls, including the internal audit, are adequate in the light of the extent of reliance placed thereon; and
- that procedures satisfactory to the External Auditor have been applied in recording all assets, liabilities, surpluses and deficits.

4. In addition, under 12.4 of Regulation XII, the External Auditor may make observations with respect to the efficiency of the financial procedures, the accounting system, the internal financial controls, and in general, the administration and management of the Organization.

## C. Audit Approach

5. A risk-based approach was adopted in the audit of financial statements. This approach requires the conduct of a risk assessment of material misstatement in the Organization's financial statements as well as the drawing up of assertion levels based on a complete understanding of the Organization and its environment, including its internal control system.

6. We identified test risk controls along transaction and non-transaction streams, and managed residual risks, particularly at the accounts/financial statement level, to provide FAO's stakeholders and intended users a high degree of confidence in the financial statements as to their fair presentation, in all material respects, in accordance with the applicable financial reporting framework and FAO directives.

7. We conducted our audits in conformity with: a) the International Standards on Auditing (ISA); b) auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI); and c) such other auditing standards that may be relevant to FAO, and other benchmarks and best practices for value-for-money (VFM) audits.

8. The issuance of the report by the External Auditor has two main objectives: a) to render an audit opinion as to whether the financial statements of FAO as a whole are free from material misstatement, and are prepared, in all material respects, in accordance with the applicable financial reporting framework and FAO directives; and b) to raise observations and recommendations on the management of FAO operations with the end view of enabling the Organization to perform its mandate in an efficient and effective manner.

9. Approximately 60 percent of the resources of the External Auditor is allocated to the financial and compliance audit while the remaining 40 percent is allocated to the Value-for-Money (VFM) audit and management reviews during the Biennium 2012-2013. The audit involves three interim audits and

a biennium-end audit. Audit opinions are issued on the financial statements of FAO, the FAO Credit Union and the FAO Staff Commissary.

10. The primary objective of the financial audit is to provide the Governing Bodies, the main users of the financial statements, with reasonable assurance that the accounts and underlying financial transactions are free from material misstatements and comply with FAO's Financial Regulations.The audit opinion will also confirm whether both income and expenditure have been made in accordance with the purposes approved by the Governing Bodies.

11. In the selection of the subjects for the VFM audit, we considered the results of our risk assessment and the priorities of FAO including those embodied in the transformation measures. The VFM audit is aimed at promoting the judicious use of FAO resources, and ascertaining the achievement of desired results and programme objectives.

## D. Audits Conducted

12. Guided by the scope of audit and in accordance with the risk-based audit plan for the Biennium 2012-2013, the External Auditor has completed two interim audits involving the following areas:

| No. | Audit Area / Office Audited | Audit Period |
|---|---|---|
| | Headquarters | |
| 1 | Review of Project Accounting | 15 Oct. to 2 Nov. 2012 |
| 2 | Review of Decentralized Accounting | 15 Oct. to 2 Nov. 2012 |
| 3 | Review of Investment Operations | 15 Oct. to 2 Nov. 2012 |
| 4 | Review of the International Public Sector Accounting Standards' (IPSAS) Accounting Policies and Technical Memos | 25 Feb. to 8 March 2013 |
| 5 | FAO Credit Union | 11-22 February 2013 |
| 6 | FAO Staff Commissary | 11-22 March 2013 |
| 7 | Audit of Financial Accounts and Transactions as at 31 December 2012 | 10-28 June 2013 |
| 8 | Review of Accountability Framework, Enterprise Risk Management and Integrity and Fiduciary Actions | 17 June to 5 July 2013 |
| 9 | Review of IPSAS Implementation | 17 June to 5 July 2013 |
| | Decentralized Offices | |
| 10 | FAO Sub-regional Office for South Africa (FAOSFS) | 29 Oct to 16 Nov. 2012 |
| 11 | FAO Sub-regional Office for Central Asia (FAOSEC) | 16 Nov. to 7 Dec. 2012 |
| 12 | FAO Representation in Bangladesh (FABGD) | 18 Feb. to 8 March 2013 |
| 13 | FAO Representation in India (FAIND) | 22 July to 9 August 2013 |
| 14 | FAO Representation in Bolivia (FLBOL) | 5-23 August 2013 |

13. The audit of decentralized offices focused on assessment of the adequacy and effectiveness of financial and administrative controls and compliance with FAO regulations. It also covered the implementation of the Country Programme Framework, the Technical Cooperation Programme, and project management. At the end of each audit, a Management Letter was issued to the concerned FAO Office. The Management Letter contained the issues or deficiencies noted during the conduct of the audit and the corresponding measures to address them, as recommended by the External Auditor. At the end of the biennium, the audit issues noted in the decentralized offices will be presented in the Long-form Report.

## E. Audit Highlights/Results of Audit

14. For the purpose of this report, the External Auditor would like to highlight the results of its audit on six areas: a) Review of Accountability Framework; b) Assessment of IPSAS Implementation; c) Review of IPSAS Accounting Policies; d) Audit of Interim Financial Statements; e) Review of Project Accounting; and f) Review of Investment Operations.

## F. Review of Accountability Framework

15. We reviewed the present Accountability Framework of the Organization from 17 June to 10 July 2013 to determine the depth and breadth of its implementation, including the related sub-components. The review was also aimed at determining accountability deficits or overloads and to find common grounds for their improvement. The JIU Report entitled “Accountability frameworks in the United Nations system” (JIU/REP/2011/5) provided the fundamental document for the review. We commend FAO Management for its initiative in enhancing accountability in its operations. Some opportunities to further enhance accountability in FAO as enumerated below were submitted for Management’s consideration:

- Embed an Internal Control Framework within the Accountability sphere to better allow risk/process owners and managers identify and implement controls and strategies in relation to risks to be managed and develop a support mechanism so that control owners and managers are able to provide the required information in the preparation of the FAO Statement of Internal Control;
- Incorporate in its plan the preparation of the Statement of Internal Control or Governance Statement to afford a more complete disclosure of the quality and expanse of internal control within the Organization;
- Adopt a formal Corporate Policy on Risk and create sufficient risk mitigation strategies to recognize risks in institutionalizing the Enterprise Risk Management (ERM);
- Finalize and implement its first Vendor Sanctioning Policy before the end of 2013 and to allocate funding resources for its implementation. Moreover, consider the recommendation of the lead departments to hire the services of a consultant or lawyer who will eventually act as Secretariat for the Sanctions Committee until a longer term resource is identified and recruited; and
- Develop and establish an internal mechanism in the conduct of investigation on cases involving the Executive Head. We emphasized that clear modalities for the conduct of investigation by an independent entity is more appropriate than conferring the jurisdiction of investigation to an internal office to prevent any speculation of bias.

16. The recommended measures will ensure an integrated and complete Accountability Framework that is in line with United Nations (UN) System practices.

17. In commenting on these recommendations:

- Management agreed with the need for robust internal control and accordingly noted that the areas of accountability and enterprise risk management, currently well advanced by the relevant Secretariat of the governing bodies, are key for the de facto embedding of a framework for internal control within the overall context of an accountability sphere.

- Management observed that while some other Organizations of the United Nations system have included a full Statement on Internal Controls (SIC) in their financial statements, this subject is under ongoing discussion in the Finance and Budget Network of the United Nations system. Management further noted that it would participate in these discussions and would consider, before an SIC could responsibly be included, the costs and benefits of such an action in the context of other needs of the Organization. Nevertheless, Management acknowledged the potential usefulness of a mechanism to monitor and escalate, as required, data on the state of internal controls.
- Management agreed that further development of the application of robust internal controls are dependent on the institutionalization of risk management in FAO. In this respect, the Enterprise Risk Management project is on course for completion, as foreseen, by the end of 2013. A corporate risk policy has been endorsed by the Corporate Programmes Monitoring Board.
- OIG, together with the Office of the Legal Counsel and the Procurement Service, has prepared FAO's first Vendor Sanction Procedures which have been submitted to Senior Management for review and approval. Management anticipates that these procedures will be finalized before the end of 2013.
- Management noted that with regard to the mechanism for investigation of allegations of misconduct against the Executive head, it addressed this matter in the context of presenting to the governing bodies a JIU report on the Ethics in the United Nations (FC 138/INF/6 ). The Director-General noted his general agreement with the extensive observations made by the United Nations System Chief Executives Board (CEB) on the report. Noting that this particular recommendation was directed at governing bodies, CEB agencies supported the development of appropriate modalities for investigating allegations brought against an executive head. The CEB agreed that developing the appropriate standards and processes in advance of such serious situations provided an opportunity for careful reflection and consideration. Furthermore, agencies noted the potential for an inherent, or perceived, conflict of interest if investigations of this nature were undertaken only by an internal service, and indicated that there was scope within this recommendation for incorporating an alternative practice, such as utilizing external entities. Agencies also pointed out a risk that frivolous or obviously unsubstantiated allegations could be automatically referred to a third party for investigation and the need for safeguards in that respect. Management believes a harmonized policy within the UN System on this matter would be appropriate, and will follow up with other UN organizations on the feasibility of developing a common proposal that could be considered by their respective governing bodies

## G. Assessment of Overall IPSAS Implementation

18. An assessment of the implementation of International Public Sector Accounting Standards (IPSAS) was conducted at FAO headquarters from 17 June to 10 July 2013. Our assessment was performed to determine the current status of IPSAS implementation in the Organization, including its governance and transitional activities leading up to the preparation of FAO’s first IPSAS-compliant Financial Statements. We commend Management for its initiative to be on track in managing the activities towards the implementation of IPSAS in 2014. Our review revealed opportunities to enhance and ensure the successful implementation of IPSAS. We recommended that FAO Management:

- Establish a concrete formal Project Governance Structure complete with well-defined roles and responsibilities and accountability lines;
- Prepare an IPSAS Post-GRMS Implementation Plan and present mainstream and support activities in a more coordinated manner to facilitate the performance of transitional activities, and the preparation of the first IPSAS-compliant financial statements in 2014;
- Finalize, before the end of 2013, the updated Financial Rules, including those that impact the management of physical assets to support management representations and those responsible for managing the same; and

- Develop one Global Inventory System that will contain facilities that will be common to all users and will address the specific needs of all departments concerned.

19. In commenting on these recommendations, Management :

- Noted that the project was addressing the actions on project governance and IPSAS planning.
- Informed that the process to update financial rules was ongoing and anticipated to be completed before the end of 2013.
- Emphasized the importance of ensuring that the implementation of any inventory system included due consideration of the costs of implementing and maintaining a system relative to the benefits which would be obtained.

## H. Review of IPSAS Accounting Policies and Technical Memos

20. We reviewed the FAO IPSAS Accounting Policies and Technical Memoranda from 25 February to 11 March 2013. The review was intended to provide guidance to FAO Management towards the successful implementation of IPSAS, and to address the risks of producing non-IPSAS-compliant financial statements. We recognized the efforts of Management to complete the necessary accounting policies and technical memoranda. The FAO IPSAS Project Team has so far developed 21 Accounting Policies and 27 related Technical Memoranda.

21. Our review disclosed that the FAO Accounting Policy 13: Reserves, fully complied with the pertinent provisions of IPSAS 1: Presentation of Financial Statements and IPSAS 28: Financial Instruments – Presentation. We further observed that 20 Accounting Policies complied with the standards except for specific concerns we noted and which need to be addressed by Management to ensure full compliance with IPSAS. These were all presented in the Management Letter.

22. We advised Management to finalize immediately the Accounting Policies and Technical Memoranda since they serve as the basis for the preparation of IPSAS-compliant financial statements.

23. Management confirmed that the Organization was in the process of reflecting the updates required to relevant accounting policies and technical memoranda and that the updated documents would be sent to the External Auditor for validation of the changes made prior to the end of 2013.

## I. Audit of Interim Financial Accounts and Transactions

24. We conducted an audit of the financial accounts as at 31 December 2012 from 10 June to 2 July 2013. Our audit covered selected accounts such as: Cash and cash equivalents; Voluntary contributions; Accounts Receivable (Advances and Prepayments); Unliquidated obligations; Expenditure – Regular Programme and Projects (Staff Costs – Salaries and Education Grant; Official Travel; Purchase of expendables and non-expendable equipment; and Contracts – Letters of Agreement). The cut-over process and data conversion from Oracle 11i to Oracle R12 were also reviewed along with the Financial Statements showing the Status of Fund of the Global Environment Facility (GEF) Trust Funds as at 31 December 2012.

25. Our audit disclosed no material misstatements on the selected accounts. However, exceptions were noted; hence, we issued audit observation memoranda which included recommended measures to address them. The exception reports and Trial Balances before and after the cut-over showed that the financial data were not affected by the system upgrade. The Financial Statements of the GEF Trust Funds likewise disclosed no material misstatements, and a separate audit report was issued thereon as requested by Management.

26. Exceptions noted included: a) unrefunded balances of trust fund to donors totalling USD 7.0 million; b) unreconciled balances of outstanding advances; c) accumulation and non-recovery of long outstanding travel prepayments totalling USD 3.3 million; d) excess payments of education grants and claims; f) non-recognition of education grant expenses in the proper financial period; and g) misclassification of expendable and non-expendable items.

27. We recommended that FAO Management:

- Intensify the review and clean-up of the financially closed projects with unexpended balances for appropriate accounting treatment and disposition;
- Initiate recovery of travel advances to staff members and consultants;
- Enforce the provisions of the Manual on education grants;
- Address the proper recognition of education grants to ensure that the balance carried forward in 2014 is consistent with the International Public Sector Accounting Standards (IPSAS) requirements on employee benefits; and
- Request Budget Holders to charge procurement activities to appropriate accounts based on FAO accounts descriptions, and ensure that all non-expendable items are captured in the database of Fixed Assets that will be carried over upon IPSAS implementation.

28. Management commented that:

- The Finance Division regularly reviews outstanding balances in order to follow up and remind donors to provide instructions for clearance of final balances;
- Noted that control mechanisms were in place to ensure that maximum education grant levels are always respected for the scholastic year in course;
- The Organization was committed to ensure the timely recovery of outstanding advances and that ongoing follow-up actions to achieve this will continue.
- Confirmed that the process for Education Grant expense recognition will be addressed as part of the new processes to support IPSAS implementation in 2014.
- Noted that a number of measures have been introduced with the implementation of GRMS which will ensure the proper classification of expenditures and correct inclusion in the asset register.

## J. Review of Project Accounting

29. A review of Project Accounting was conducted at FAO Headquarters from 16 October to 07 November 2012. It covered the review of the adequacy and operational effectiveness of existing policies, controls and established procedures pertaining to the following activities on project accounting under the responsibility of the Project Accounting Group (PAG): a) Project set-up and budgets; b) Financial clearance, funding, monitoring and reporting; and c) Final accounts and statutory financial reporting.

30. We noted that the budget for extra-budgetary projects for biennium 2012-213 is estimated at USD 1.3 billion. It comprises 58 percent of the total biennium budget of USD 2.4 billion. We further noted that in the new Project Cycle, the Finance Division first gets involved during the third Phase – Appraisal & Approval, where project financial clearance is sought prior to implementation. As it is primarily aimed at ensuring that the financial clauses contained in the project/funding agreements are acceptable to FAO, our audit showed that a lack of documentation does not allow independent assessment on the propriety, transparency and responsibility for the processes undertaken.

31. Both the Finance Division and the Budget Holder play key roles in the project implementation processes. Upon project completion, the biggest impediment to project financial closure is when the project has a budget and/or cash deficit. The main causes for such deficits identified during the audit included currency exchange losses, donor disallowances or cost ineligibility, and lapses on the part of the Budget Holder. Much of our audit focused on the need for FAO to implement a rigorous accountability framework; otherwise, FAO shall continue to be exposed to financial risks and losses.

32. Final financial reporting ensues after project financial closure, where project fund balances are disposed of. As at 30 September 2012, there were 261 financially closed projects with unliquidated balances totaling USD 7.2 million. These balances have remained outstanding, ranging from six days to 11 years, due to the lack or insufficiency of donor instructions in the project agreements.

33. We recommended enhancements to existing policies to include a mandatory and standard provision on the manner and period of disposition of unspent balances, exerting efforts to encourage donors to have them transferred to other FAO activities rather than refunded. This is to prevent an

unfavorable impression on stewardship of funds among donors and other stakeholders. Management noted that it would review the possibility to include such clauses in donor agreements.

34. We recognize Management's various reforms and initiatives that are undeniably geared towards enhancing the accountability framework, internal control systems, resource empowerment and the various processes involved including the area on Project Accounting. In the context of audit, recommended actions and considerations on improved policy, controls and procedural matters in the areas covered are discussed in greater detail in the Management Letter with the objective of complementing FAO's on-going efforts to better shape its direction for an efficient and sustained implementation of its programmes.

## K. Review of Investment Operations

35. We reviewed the existing FAO investment policies, together with the custody agreement with the Investment Custodian and the respective investment agreements with the Investment Managers. The review was conducted from16 October to 07 November 2012. It included the confirmation of the total investments held by the Investment Custodian and the Investment Managers as at 30 September 2012.

36. FAO's investments, which stand at USD 1.1 Billion, or 78 percent of its USD 1.4 billion assets as at 31 December 2012, are its largest balance sheet item. On this note, we recognize that every investment, by its very nature, has associated risks. In FAO's case, investment performance has a direct and immediate impact on the funding of the staff-related plans and other projects. Effective management of investments has thus been of primary concern for FAO, as evidenced primarily by the daily monitoring of the investment returns by the Investment Unit, the delegation of important functions and decision-making to the Investment Committee, and the establishment of the Advisory Committee on Investments.

37. Amidst the complexity of investment transactions, a fundamental, yet significant, component of an effective investment management is a properly written Investment Policy Statement (IPS) as it provides the roadmap to achieve desired results. In the review of its existing IPS, FAO could be guided by the IPS of other UN agencies and credible investment institutions. These benchmarks were devised through collaborated efforts of experts, thus giving FAO reasonable assurance that the framework laid down therein is rightfully attuned to the needs of decision-makers.

38. FAO considerably relies on the services and performance of its Global Custodian and external Investment Managers. For this reason, the selection, termination, monitoring and evaluation of the performance of the Global Custodian and Investment Managers are among the crucial elements in the overall spectrum of FAO investment governance. To effectively carry out this mandate, we recommended that FAO Management enhance its current policies by integrating therein the: a) Terms of Reference of the key players involved in the investment operations, including the authorities and responsibilities of the Investment Committee, the Advisory Committee on Investments and the Treasury Operations Group; b) criteria and relevant processes in the selection and termination of Investment Managers; and c) responsibility and process involved in the conduct of on-site visits.

39. Management agreed with the overall recommendation and noted that action will be taken on this in future revisions of policy papers during 2014 and 2015.

40. Further, we noted that the actual return on investments with HSBC and Northern Trust is around 0 or 0.01 percent . We advised Management to revisit the positioning of existing portfolios and explore relevant avenues to strike a balance between risks and returns that will eventually result in optimal benefits.

41. Management observed that FAO's investment positioning is implemented in full compliance with the agreed strategic asset allocation strategies and investment policies, endorsed by the established Governance arrangements and that current rates of return reflect the importance attached by these strategies and policies to balance both risk and return on investments. Management further commented that current market conditions dictated that highly secure, short-duration EUR investments currently yield near zero and even negative returns and actual returns were in line with expectations.

## L. Next Steps

42. To complete the work of the External Auditor for the current biennium, the External Auditor will a) perform further reviews of the IPSAS implementation (Project deliverables and follow-up of status of implementation of recommendations related to IPSAS); b) perform an assessment of controls embedded in GRMS that impact financial statements presentation; c) perform an operations review of Human Resource Management, Technical Cooperation Programme; and d) perform a review of FAO plans and programmes with focus on strategic objectives I, A and H.

43. There will also be an audit of other decentralized offices, namely, FAO Regional Offices in the Near East (FAORNE), Africa (FAORAF), Asia and the Pacific (FAORAP), the FAO Representation in China and the FAO Office for Thai Affairs.

44. The biennium-end audit of the financial statements for 2012-2013 will be conducted from May to June 2014. These will be the last financial statements to be prepared by FAO under UN System of Accounting Standards (UNSAS) in view of the adoption of IPSAS as the financial reporting framework effective 2014. The Long-form Report of the External Auditor for the Biennium 2012-2013 will be presented to the Finance Committee meeting in the autumn of 2014.

## M. Collaboration with the OIG and the FAO Audit Committee

45. We have continuously collaborated with the Office of the Inspector General (OIG) to achieve synergy in audit and avoid unnecessary duplication of efforts. The latest collaboration meeting was held on 7 October 2013.

46. The External Auditor also presented her status of work to the FAO Audit Committee during its meeting on 1 August 2013 and noted their appreciation on the comprehensiveness of her audit activities.

## N. Acknowledgement

47. The External Auditor, Ms Maria Gracia Pulido Tan, wishes to express her appreciation to the FAO Finance Committee, through Chairperson Médi Moungui, for the opportunity to present her status of audit work in the Organization for the Biennium 2012-2013. She further extends her thanks to the Committee for the appointment of the Philippines' Commission on Audit as the FAO External Auditor for the period 2014-2019.