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BOARD OF AUDITORS

NEW YORK

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Opening remarks to the
Advisory Committee for Administrative and Budgetary Questions (ACABQ)
on 20 September 2010
by Imran Vanker, Director, External Audit, South Africa
and Chairman, Audit Operations Committee
United Nations Board of Auditors

Madame Chair and Distinguished Members of the Advisory Committee,

Good morning. We thank you for your invitation to appear before the Committee and for your Secretariat's flexibility in accommodating the availability of the AOC. We always say when we meet you, and we hear you say, that as partners in oversight matters, the ACABQ and the Board enjoy a special relationship. Today is another one of those occasions when I would like to repeat that. To put this in its correct perspective, for the last two years, we have planned audits, we have visited field offices, we have reviewed working papers and we have argued for the inclusion of matters in our reports saying each time that this is an important matter which the ACABQ will be interested in. Today and during the next few days will be an opportunity for us to share with you all that we have identified and we are looking forward immensely to hear your reactions to these findings.

I would now like to introduce my team. Let me start first by introducing the newest member of the team. His name is Hugh O'Farrell and he represents the Auditor General of the United Kingdom, and he has since July this year, assumed the responsibilities previously undertaken by our French colleagues. I would like to assure you that the Board and AOC have been very diligent and detailed in the handover activities and that the UKNAO has very quickly taken up a fully fledged role in our Board. Their teams are already making great progress with their audits. The Board, during its July 2010 session, heard confirmation from the incoming Board member that he was entirely satisfied with the handover arrangements that we had provided and ACABQ can take comfort from this assurance that there will be no gaps arising from the change of auditors.

Introduce Mr. Myard, outgoing Director Mr. Hu, incoming Director Mr. Liu and Mr. Goolsarran and teams

We are also pleased to meet for the first time the newly installed members of ACABQ, Mr. Akira Sugiyama and Mr. Anupam Ray and we do very much look forward to working with you as we did with your predecessors.

Madame Chair,

We appear before you as the only independent external auditors of the United Nations. This is a status reaffirmed many times by the General Assembly and which for the last 65 years, successive members of the Board have held very dearly. What this means is that in the reports that you have, and in the responses that you will get from us today, you can be certain that we have brought our highest levels of independent and expert judgement to the various matters that we faced.

Many stakeholders that we interact with over the biennium asked us what happens to our audit reports once we have signed them. I think this question is usually asked with a view to understanding how the process of oversight in the UN is fully implemented. We all know that the audit does not end with our audit report, or with the editing and publication of these reports, but that our meeting with you today and our subsequent meetings with the Fifth Committee are the interactions that help convert effective oversight into effective accountability.

The way we answer the question about what happens to our reports is by mentioning first and foremost that our reports are deliberated on by ACABQ. So today is important for <u>that</u> reason also, because these discussions lead to building of confidence among stakeholders that there is an orderly system of reporting, leading to oversight and ultimately, to accountability.

While our primary purpose is to give you answers to various questions today, we are also professionally bound to use this opportunity to better understand the risks that you see the Organization facing, and to understand your interests. I therefore, should say that we are not only interested in your questions, but equally interested in considering the comments that we will hear you make. What we will do with those comments is consider them during our audit planning for the new biennium which is presently under way.

The reports that you have today, represent about 2,200 auditor weeks of effort. This excludes the time that we spend auditing peacekeeping and those reports which do not come to ACABQ. We are pleased to report to you that during this biennium we did not encounter any limitations on our scope or restrictions of access to the records and individuals and that we generally enjoyed excellent support from the various Administrations wherever in the world we audited. Annex I of the Concise Summary describes for you the allocation of assignments among members of the Board. This table indicates who the lead auditor is for each assignment and this will help give members of the Committee an indication of who will be answering primarily the questions that you will pose on different reports.

Having made these preliminary remarks, it is now my pleasure on behalf of the Chairman and Members of the Board to introduce for discussion the reports of the Board of Auditors which are listed with their symbol numbers in the same Annex of the Concise Summary. We have been advised not to introduce the report on the Capital Master Plan as you will only be considering this later in your session. The other reports not being introduced to you today are the other reports which go to the Security Council directly (UNCC and Iraq Escrow) as well as some specially mandated reports which represent a subset of findings from the reports that you have today. For example, we do a special report on the UNRWA Microfinance Department, but we have included the significant findings from that audit in the UNRWA report that you now have.

In these opening remarks, I am going to address four topics. They are the audit reports and audit opinions of the Board; secondly, the status of recommendations; thirdly, the matters of general concern (we have seven such areas) and then the significant issues and in this area I will be covering ten topics.

Arising from the audit of each UN entity, the Board makes observations, considers the root causes and possible impacts, and then makes recommendations to address the gaps it observed. The focus and implementation of the Board's audit recommendations is an indicator of the organisation's capacity to bring about change in controls and processes that were identified as needing improvement. Also, the follow-up by internal auditors and the concern of legislative bodies in relation to audit recommendations is essential to the strengthening of oversight of the UN entities.

The Board has assessed the implementation of its recommendations and has included in an annex to every report, the status of each organisation's implementation of the Board's recommendations for the financial period ended 31 December 2007. A table summarising the status of implementation of the recommendations by organisations is contained in Annex II of the Concise Summary report.

Overall, the rate of implementation of the Board's recommendations decreased from 64 per cent to 59 per cent. Of the total of 518 recommendations made in the 2006-07 biennium (2004-05: 788 recommendation), 305 recommendations (59 per cent) had been fully implemented, 169 recommendations (33 per cent) were partially implemented, sixteen recommendations (3 per cent) were not implemented, twenty eight recommendations (5 per cent) were overtaken by events. In each individual report, the Board has highlighted, where applicable, specific reasons and challenges relating to delays in implementing certain recommendations.

In line with General Assembly Resolution 47/211, the Board invites the Administrations to allocate specific responsibility for the implementation of all recommendations to individuals or divisions and to do so within a predetermined time frame, so that there will be in improvement in the rate of implementation of recommendations.

In accordance with General Assembly resolution 61/233 A, regarding the adoption of the International Public Sector Accounting Standards, the Board assessed the status of implementation of those standards in UN entities. The Board noted that all the entities delayed their implementation of IPSAS from January 2010 to January 2012, with the United Nations (and related entities) further delaying their implementation to January 2014. The Board was disappointed at the postponements and the delayed benefit of introducing a significant improvement in financial reporting. We look forward to sharing with you our further views on this.

Madame Chair,

Let me now make a few remarks on the matters of general concerns identified by the Board during the biennium, some of which emanate from requests by the legislative bodies to perform a review of specific matters in line with Article VII of the Rules and Regulations of the UN.

IPSAS

First among these, is the progress by entities in implementation of International Public Sector Accounting Standards (IPSAS). This area continued to receive greatest attention by the Board during the biennium. IPSAS poses a significant opportunity, but also a large risk to organisations if the implementation is not properly carried out. The flexibility for compliance embodied in UNSAS will be replaced with stricter IPSAS rules, allowing less flexibility and demanding greater attention to record keeping, selection of accounting policies and data gathering for disclosures. These issues translate into challenges for organisations in future to maintain or improve the audit opinion given on their financial statements.

In accordance with General Assembly resolution 61/233 A, and in response to the comments of the Advisory Committee on Administrative and Budgetary Questions in its report A/61/350, the Board undertook a gap analysis relating to the implementation of the International Public Sector Accounting Standards, as well as new or upgraded enterprise resource management systems. As part of its consideration of the implementation of IPSAS projects, the Board considered the state of readiness of client organisations as reflected in their IPSAS plans.

From the its review, the Board has observed within the respective Finance units a generally high sense of awareness and growing preparation for IPSAS. The Board welcomes this development. The emphasis on skilled staff, change management, training, ERP-readiness and high level support are all key ingredients of a successful implementation.

IPSAS is indeed a major reform initiative that will assist in addressing the key financial reporting needs of the organisations. In some cases, IPSAS may also herald the introduction of ERP-systems, which will provide the opportunity to improve or re-engineer a variety of internal processes. However, the Board records a note of caution that: (a) the timely implementation of IPSAS and ERP's will not alone fix the myriad of management challenges various organisations face; and (b) the implementation projects themselves will give rise to significant management challenges. The Board underscores the importance of adequate project management techniques throughout the IPSAS project life cycle to ensure that the project and its dependencies are implemented in timely manner.

In each report, the Board has highlighted some of its particular findings, and will continue to keep this matter under review, and provide its inputs where relevant.

A **second** area is the matter relating to the After-service health insurance and end-of-service liabilities. In accordance with General Assembly resolutions 60/255 and

61/264, the Administration was tasked to change the presentation of end-of-service and post-retirement liabilities from disclosure in the notes to the financial statements to accounting and presentation on the face of the financial statements.

In this biennium, we observed that all the organisations reported upon have estimated their respective liabilities in relation to their staff who are eligible for various benefits either upon their end of service or after their end of service. However, as in the previous biennium, UN organizations continued to make book entries in varying degrees in relation to those liabilities. While some entities have made accounting entries to record the liabilities in full, other entities made accounting entries for less than the full liabilities but included the relevant disclosure of the full liabilities in the notes to the financial statements. The aggregate amount of the estimated liabilities was $3.9 billion (2007: $4.1 billion) as at 31 December 2009. This included: $3.1 billion for the After-Service Health Insurance, $225 million for leave liability, and $356 million for repatriation benefits. These values decreased compared to those as at 31 December 2007 mainly as a result of changes in the accounting policies and estimation methods of the organisations.

In its resolution 64/241, the General Assembly requested the Secretary-General to continue to validate the accrued liabilities for After-Service Health Insurance (ASHI) with figures audited by the Board and to include this information and the outcome of the validation is his report to the sixty-seventh session of the General Assembly. In response to this request, the Board reviewed the actuarial valuation of the accrued liabilities for ASHI, within the limits of its own mandate as set out in Article VII of the Financial Rules and Regulations of the United Nations and the annex thereto, and in accordance with the International Standards on Auditing.

Generally, the Board noted that most organisations had still not made a decision regarding the funding of the Organization’s future obligations towards its employees. Moreover, in some organisations, the recording of liabilities led to negative reserves and funds balances, and the Board was concerned that there was a risk that the organizations might not be in a financial position to fully meet their obligations with regard to end-of-service liabilities and post-retirement benefits as and when those liabilities become due.

In comparison to the valuation methodology used in the last biennium, there were some changes in many of the actuarial assumptions used to value the ASHI liabilities. In particular, in the previous valuation of the ASHI liability, most organisations had used a discount rate of 5.5 per cent. The valuation of the ASHI liability as at 31 December 2009 was based in most organisations on a discount rate of 6.0 per cent, which was based on rates of return of high-quality corporate bonds. The Board acknowledges that this methodology is compliant with IPSAS 25, yet was of the view that (a) The increase in the discount rate does not reflect the trend in interest rates which have generally tended to decrease over the recent period and (b) The valuation is only an estimate of the actual value of the liability and that valuations based on standards other than accounting ones may yield different results. In this regard, the Board wishes to underline that a financial valuation of the funding needs (or “funding valuation”) would result in a different value than the accounting valuation which, is generally more conservative.

With regard to annual leave liabilities, we have also found that UN entities in general made some changes to method of estimation of annual leave liability during the biennium. Whereas the annual leave liability had previously been estimated using the current-cost methodology, most organisations changed their accounting policy and calculated the annual leave liability based on an actuarial valuation performed by an external consultant.

The Board concluded that the annual leave liability calculated through the actuarial valuation was not appropriate as it: (a) included future days to be accumulated; and (b) was a discounted amount. The Board thus proposed that organisations consider revising their policy for the valuation of leave liabilities during their implementation of IPSAS.

A **third** area of concern covered by the Board relates to the Financial Regulations and Rules of the United Nations entities. While there could be other areas of harmonisation of business practices, process and procedures in the UN organizations, the Board noted inconsistencies in matters that affect the financial statements of the UN organizations, entrenched through or unchallenged by the financial regulations and rules of the respective entities. These included the layout of financial statements, accounting policies, and dates of submission of financial statements. The Board is concerned that the inconsistencies have the effect that important parallels cannot be drawn by comparing the financial statements of the UN entities. Also, divergent rules may result in differentiation in entities to obtain competitive advantage in sourcing funds from donors. The Board is of the view that the inconsistencies in the rules and regulations should be considered in parallel with the implementation of the new IPSAS accounting standards.

A **fourth** area covered by the Board was in relation to the National Execution modality. This is a modality whereby funds are advanced to implementing partners (governments and non-government organizations), with the implementing partner presenting expenditure reports and audit reports to UN organisations to account for how funds were expended. UNDP, UNFPA and UNHCR utilized the NEX modality, while UNICEF applied a modality similar to NEX where UNICEF provided governments with direct financial support, called Cash Assistance to Government (CAG).

The Board noted differences in the application of the NEX modality among entities in that the entities apply different rules and procedures in the management of the NEX audit process, including the amount of expenditure subject to NEX audit by third-party auditors and the timelines for the receipt of NEX audit reports.

At UNICEF, Cash Assistance to Governments do not require mandatory audits similar to the NEX audit process with the result that there was a possibility of less assurance being provided by this process alone than that provided through the audit process. The Board's findings with regard to NEX and Cash Assistance to

Governments modalities reflect that there is a need to ensure consistency in approach. The Board notes the initiative to implement a Harmonized Approach to Cash Transfers (HACT), and will keep this initiative under review.

The fifth area that we covered relates to Procurement and contract management. The Board noted several issues that stem from the imprecise legal and procedural framework applicable to the support of the special political missions by Secretariat headquarters. As a result, these missions did not have a proper delegation of procurement authority, but nevertheless engaged in procurement activities.

In several UN entities, the Board noted many instances of non-compliance with the procurement rules. The Board also noted that there was lack of adequate procurement planning in some entities, whilst vendor database management practices needed improvement. Procurement remains a high risk area which if not well managed has the potential to undermine the integrity of the UN system.

The **sixth and seventh** areas relate to non-expendable property and expendable property management. It is important to note that a number of entities have in the past received modified reports because of these two areas. The Board is concerned that this trend continues in some reports under consideration by the Committee.

Whilst non-expendable property is defined differently across the United Nations and its funds and programmes, the Board estimated that the aggregate value of non-expendable property disclosed by entities exceeded well over a billion dollars. As many organisations undertake physical verifications and valuations during their preparation for IPSAS, it is likely that the disclosed amounts will change materially. The Board noted efforts by UN entities to improve the management of non-expendable property during the biennium, however, there were still several weaknesses that have previously been reported by the Board.

In relation to expendable property, the Board extended its review to expendable property during the biennium, as follow-up of its previous audit findings, the recognition of the sometimes significant expenditure represented by expendable property and in anticipation of the accounting and disclosure needs under IPSAS.

At several entities, the value of expendable property was not disclosed on the face of the financial statements or in the notes to the financial statements. The Board has in its reports noted several areas for improvement in relation to the management of expendable property.

The Board is of the view that the introduction of the International Public Sector Accounting Standards should also be an opportunity for the organizations to adopt harmonized rules for the management and accounting of expendable and non-expendable property. The Board indeed found that the existing rules applicable to expendable and non-expendable property diverged from one organisation to the other.

Madame Chair,

I have also summarized some significant issues that emanate from our audits.

Financial statement matters refers to items that were not adequately recorded in the accounting records, or adequately disclosed or reflected in the financial statements or notes to the financial statements. The Board found several weaknesses in the management and recording of unliquidated obligations and receivable and payable balances. The Board also noted instances where reconciliations, which are a major control in an accounting function, were not adequately performed.

The Board found that there were a number of trust funds at UN entities. The Board also found cases where **trust fund balances** are maintained by UN entities with no activities to utilize the funds or pay back the funds to respective donors, during the biennium.

In accordance with the ACABQ request (A/63/474), the Board continued to place emphasis on the review of **results-based budgeting**. The Board has noted a variety of issues across organisations. These are: (a) Management Work plans were not always submitted on time and were not always approved; (b) the indicators of achievement not were specific, measurable, realistic and timely; (c) the Board could not verify some of achievements as not all the information in the performance reports were backed up by documentary evidence; and (d) sometimes the relationship between the expected accomplishment and the corresponding objective were not clear.

The Board's review of **cash and investment holdings** as at 31 December 2009 indicates that there was approximately $18 billion of cash resources that were held as either investments or cash. The balances were attributable to various reasons such as the contributions received in advance (that is before the activities are due to be carried out), working capital funds, cash held while implementation activities were underway, and/or prior period unused (cash) resources, and/or surpluses.

The management of cash resources is a significant responsibility of the administrations and as cash balances grow, and the number of accounts, transaction and payment currencies increases, so do the needs for systems and trained personnel, so that risks are properly managed and the returns on cash resources are maximised. The Board uses this opportunity to present this global picture of the cash balances, and will keep this under review in future assignments. The Board noted that the amount for cash and term deposits, investments and cash pools is based on different accounting rules and conventions and should thus be considered only an estimate of the total value. The Board also noted some minor weaknesses in the management of cash at UN entities.

The Board noted various weaknesses in relation to **programme and project management** practices by UN entities including the need to harmonize accounting methods for the payments made to implementing partners at UNEP, reconciliation of amounts paid to UNDP to implement nationally executed projects by UNODC, establishment of project management manual at UNU, and management of long outstanding advances to implementing partners at UNDP.

On **human resources**, the Board continued to note that vacancies were not always filled in a timely manner and that this finding was prevalent among UN entities. The Board also noted that staff performance evaluation reports were not always prepared and completed within deadlines, whilst there were some short-comings in the control and process over leave administration and management such as the maintenance of manual leave records.

The Board performed an information technology general controls review for some UN entities and noted that there were short-comings mostly in change control processes and user account management processes. The Board also noted inadequate physical access and environmental controls to the server rooms.

The Board noted that there are different rules governing **travel manage**ment between the United Nations and its funds and programmes. The Board noted weaknesses in travel management across the entities as follows: (a) travel requests were not always submitted within the prescribed time before travel, sometimes were submitted after travel date; (b) travel claims were not always submitted after completion date of travel; and (c) in certain instances there was lack of monitoring of travel advances leading to a high level of long outstanding receivables.

The **internal audit functions** of the United Nations and related entities are performed by the Office of Internal Oversights Services (OIOS) and most funds and programmes have their own in house internal audit functions. The Board has during the biennium strengthened its coordination with internal audit function at the UN entities, which is reflected in each report by vastly enhanced disclosures of internal audit matters.

The Board was concerned that internal audit plans were not fully completed which was mainly due to vacancies in the respective internal audit units.

The Board emphasises the special knowledge of organisations that internal auditors have that can be mobilised in coming years during the implementation of IPSAS and that the internal auditors could be well-placed to provide internal critical sounding board for the benefit of management during implementation of ERPs.

There are other entity specific matters that are contained in the individual reports of each entity. If these items are to be included in these preliminary remarks, it may to considerable time to go through each. However, I am hopeful that these remarks have provided you and your committee with a quick glance at the contents of our reports that are under your consideration.

Madame Chair, Distinguished Members,

Thank you!