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**Executive Board
Second Regular Session**

Rome, 7–11 November 2005

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

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ANNUAL REPORT OF THE WFP AUDIT COMMITTEE

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NOTE TO THE EXECUTIVE BOARD

This document is submitted for information to the Executive Board.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

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Chief of Staff and Director, OED*: Mr M. Stayton tel.: 066513-2002

Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact Ms Cynthia Panlilio, Administrative Assistant, Meeting Servicing and Distribution Unit. (tel.: 066513-2645).

* Office of the Executive Director.



To the Executive Board

As required by its new Terms of Reference, the Audit Committee reports annually to the Executive Director and, through his Office, to the Executive Board.

As the Audit Committee had been in existence for less than a year, our initial report to the Executive Director covered the period to 30 April 2005. The contents and issues it raised were discussed with the Executive Director at our April 2005 Audit Committee meeting.

Issues raised with the Executive Director are likely also to be of interest to the Board, so our first report to the Board is this first report to the Executive Director, updated to incorporate the discussions at our 22 July 2005 meeting.

It is intended that this report will be presented to the Board for information at its November 2005 meetings. It will be followed up by our second report early in 2006, which will be presented to the Board for discussion through the Office of the Executive Director. The intention is that the Chairperson of the Audit Committee will make that presentation and answer any questions relating to the committee's mandate and work to date.

J. Graham Joscelyne – Chairperson

29 August 2005

REPORT TO THE EXECUTIVE BOARD

Purpose

As required by the new Terms of Reference, this is the first report to the Executive Board by the Chairperson of the Audit Committee of WFP. It covers the period from August 2004 to July 2005. Its purposes are to report on the work of the Audit Committee during this period, and to make recommendations to the Executive Director with regard to changes to the committee's mandate.

The basis of this report is one issued to the Executive Director, which was discussed and agreed on at the April meeting between the Executive Director and members of the Audit Committee.

1. Introduction

- 1.1. For the past 20 years, WFP has had an Audit Committee that reports to the Executive Director. Recently, the members of this committee consisted entirely of senior staff of WFP, whereas previously there had been a combination of senior staff and external members.
- 1.2. The Executive Director wanted to establish an international best-practice governance model for WFP, a move supported and encouraged by the External Auditor. The proposed arrangement was intended to strengthen the integrity of arrangements within WFP and advance good corporate governance generally. Most of the members of the new Audit Committee, including the Chairperson, were to be external to WFP.
- 1.3. To this end, the Executive Director issued a circular dated 6 July 2004 (Annex I).
- 1.4. A number of experienced professionals were invited to consider serving WFP as external members. From this group, the Executive Director made a final choice of three:
 - Mr J. Graham Joscelyne, retired Auditor General of the World Bank (Chairperson);
 - Ms Jessie Rose Mabutas, then Director of the Office of the Under-Secretary-General for Management, now Director of the Office of Audit and Performance Review, United Nations Development Programme (UNDP); and
 - Mr John Parsons, Director of the Internal Oversight Service, United Nations Educational, Scientific and Cultural Organization (UNESCO).
- 1.5. The Executive Director also appointed two senior managers to the new Audit Committee: Mr Michael Stayton, Chief of Staff and Director of the Office of the Executive Director; and Ms Diana Serrano, then Head of Human Resources, now Director of Legal Services.
- 1.6. The result was the formation of an Audit Committee chaired by an external member, largely independent of management, professionally competent and empowered to advise and assist the Executive Director on governance issues in WFP while remaining within the existing governance mechanism of WFP as a whole.
- 1.7. The new Audit Committee met for the first time on 6 August 2004 in Rome. It has met four times since then, most recently in July 2005.

2. Mandate

- 2.1. The Audit Committee was presented with a draft mandate. After consideration, it revised the scope of its activities to bring them more into line with international best practice and resubmitted the draft to the Executive Director for comment and approval.
- 2.2. The mandate provides for its own revision as needed and as the work of the committee becomes clearer in the light of prevailing issues, both internal and external to WFP. This is important because it allows the Audit Committee and the Executive Director to reconsider the committee's relevance, focus and composition at least annually; it also accommodates the evolving nature of the oversight responsibilities of the Board and the oversight committees reporting to the Board.
- 2.3. The scope of the revised draft mandate is appropriate and follows international best practice.
- 2.4. Best practice stresses the need for an independent Audit Committee. The current model will therefore need to be reviewed in two ways:
 - **Reporting.** The Audit Committee does not report directly to the Executive Board, as best practice recommends. It does, however, report to the Executive Director, with a link to the Executive Board through his office. Although indirect, this arrangement has strengthened the Audit Committee's independence. Its sufficiency is likely to be debated and tested as the committee's role becomes clearer in relation to the responsibilities of other oversight bodies providing advice to the Executive Board on financial and administrative matters, in line with WFP's financial regulations. It was recommended that the Executive Director review the reporting lines to ensure an appropriate level of independence for the Audit Committee.
 - **Conflict of interest.** A minority of Audit Committee members are senior line managers of WFP. They have consistently demonstrated independence of mind during meetings, and have gone out of their way to ensure that the committee's work takes precedence. However, best practice requires complete independence. There have been advantages in having a minority of members familiar with WFP, but this can also be achieved through attendance rather than membership. It was **recommended** that the Executive Director review the composition of the Audit Committee to avoid any perception of conflict of interest. The Executive Director is fully supportive and has taken action on this recommendation, and it is anticipated that a satisfactory solution will have been implemented by the time of our next report.
- 2.5. We note with appreciation the advice and assistance provided by the External Auditor, the National Audit Office of the United Kingdom, which drew on its international experience while keeping in mind WFP's existing governance arrangements.
- 2.6. The final draft of the mandate was approved by the Executive Director during the 99th Audit Committee meeting on 14 January 2005.
- 2.7. The Executive Director's circular announcing the final Audit Committee mandate is attached (see Annex II).

3. Role and Functioning of the Audit Committee

3.1. Participation

3.1.1 Mindful of its broader mandate and in line with best practice, the breadth of the various parties' participation in the Audit Committee's work has improved. In particular:

- i. the External Auditor, represented by a senior official, participates in all meetings and all briefings;
- ii. the internal audit function, the Office of Internal Audit (OSDA), is a full participant;
- iii. the investigations function, the Office of Inspection and Investigations (OSDI), is also present and now provides information relevant to the mandate;
- iv. operational management participates on a subject-by-subject basis at the executive management level;
- v. administration and financial executive management have been fully engaged; and
- vi. the Executive Director has been supportive through his attendance by being kept informed of the committee's activities by his senior staff, through discussions with the Audit Committee Chairperson and through an executive session with the Audit Committee.

3.1.2 As a result, the profile of the Audit Committee has risen; it interacts with executive management and there are indications that this is having a positive effect on the control consciousness of WFP. In particular, the committee is better positioned to offer an increased level of assurance to the Executive Director as a result of its improved interaction with management, its objective review process and the fact that it provides independent but constructive challenge.

3.1.3 Its remaining challenge is to engage operational management more fully in all its deliberations, as best practice recommends.

3.2. Agenda formulation

3.2.1 The Audit Committee has focused on identified risks and has contributed to the decision-making process on appropriate issues, in line with its mandate. In its advisory capacity, it has reviewed and will continue to review certain reports that flow to the Executive Director and through his office to the Executive Board.

3.2.2 Agenda topics, pre-meeting briefings and management participation have focused on risk, risk management and related exposures, and how WFP can improve in these regards. A standard item on the agenda is the discussion of emerging risks, from Iraq to the tsunami crisis.

3.2.3 The purpose is to encourage management and the Audit Committee to discuss risk issues that could have an impact on WFP in the future. The results so far have been positive.

3.3. Pre-meeting briefings

- 3.3.1 Each formal meeting has been preceded by briefings for external members on a range of topics such as risk management, the WFP Information Network and Global System (WINGS) upgrade, various audit reports, and management response to them, the Oil-for-Food programme and the ongoing Volcker investigation, tsunami relief efforts, the internal auditor's mandate and audit programme and the work of the External Auditor.
- 3.3.2 These briefings provide context, allow in-depth discussion and are essential to the work of external members. It is intended that these meetings will form an integral part of the formal proceedings because of the nature of the discussions, the volume of work and the limited time available to members, all of whom will soon be external to WFP.

3.4. Follow-up mechanism

- 3.4.1 The Audit Committee has emphasized a more rigorous follow-up mechanism to ensure that management responds promptly to the issues it raises, follows up and reports back to the committee. Data in this tracking system are updated at each meeting so that management and auditors can give prompt attention to important issues.
- 3.4.2 The Audit Committee also receives regular feedback on the implementation status of recommendations made by both the external and the internal auditors, and follows up with management to ensure that there is timely action.

3.5. Field visits

- 3.5.1 The Chairperson visited the Southern Africa regional bureau in December 2004 and the Kenya country office in April 2005 to acquaint himself with their operations. The directors provided valuable insight regarding WFP's operations, with a particular emphasis on how risk is managed at the field level. In view of WFP's work and its decentralized structure, the Audit Committee will be encouraged to make field visits from time to time to gain insight and see first-hand how risks are identified and managed in the field.

3.6. Executive session

- 3.6.1 As a routine matter, the Audit Committee holds an executive session with the Executive Director. The purposes of this are to permit a free exchange of thoughts and views and to interact with the Executive Director when only Audit Committee members are present. This best practice will continue at least annually.

4. Issues Arising from the Audit Committee's Work

Through our work, certain issues were raised that require management leadership to ensure that they are adequately addressed.

4.1. Risk management in general

- 4.1.1 The Audit Committee notes that to date WFP has not adopted a comprehensive risk management framework such as the Committee of Sponsoring Organizations of the Treadway Commission (COSO)¹ or Enterprise Risk Management (ERM). International best practice recommends such a framework as the best way of ensuring that:
- i. the control environment of WFP is formally considered;
 - ii. risk and control are explicitly and comprehensively addressed;
 - iii. there is a consistent approach to risk assessment and the management of exposures; and
 - iv. information flow, reporting and communication across WFP are accurate and timely.
- 4.1.2 The adoption and implementation of such a framework requires sponsorship at the executive level, resources to ensure implementation and sustainability, and the commitment by management across WFP to develop a consistent risk management culture.
- 4.1.3 The Audit Committee is aware that an initiative started by OSDA in 2003 resulted in an ERM project being started in 2005, the steering committee of which comprises senior and executive management of WFP. The objective is to establish a framework and methodology and to support the embedding of risk management into all areas of the business and all levels of WFP.
- 4.1.4 The stated management strategy in the draft ERM policy is to implement a framework based on the COSO Enterprise Risk Management Integrated Framework. The committee encourages the implementation of such a formal framework in order to provide the level of assurance that it needs.
- 4.1.5 In its meetings the Audit Committee has discussed risk issues with senior management, particularly regarding identification, assessment and control of risks; the committee also remains interested in residual exposure and how this is being monitored and reported. Management has responded thoughtfully throughout, leaving the Audit Committee with the impression that risk and risk management receive attention.
- 4.1.6 At its July meeting, the Audit Committee reviewed the final draft ERM policy document and made suggestions that, if implemented, will enhance the policy and its implementation. As required by its mandate, the Audit Committee will monitor carefully the implementation of ERM.

4.2. Oversight services (OSD)

- 4.2.1 These services are a major provider of assurance to the Audit Committee. It is critical that these functions be appropriately focused and adequately resourced.

¹ This is a voluntary organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls and corporate governance.

- 4.2.2 To this end, the Inspector General and Oversight Services Division (OSD) draft Charter and the OSDA 2005 Audit Plan were presented to the Audit Committee on 13 and 14 January 2005. The OSDA Audit Plan was driven largely by the approach of giving priority to the auditing of field offices. In 2004, the Executive Director provided OSDA with resources additional to that year's plan in order to facilitate increased field office visits, and management has made commitments to continue such support.
- 4.2.3 After debate, the following proposals were made:
- i. The Charter should be redrafted to simplify it and ensure that it is in line with internal auditing professional practice. The subsequent redraft has been approved by the Audit Committee and the Executive Director. At our last meeting, one amendment was approved to clarify that the scope covered internal governance matters only.
 - ii. The entire audit effort should have a risk assessment as its base, and this should be carried out in time for presentation of the 2006–2007 Audit Plan later this year. The Audit Committee will discuss this risk-based plan at its October meeting.
 - iii. For 2005, the field office component should be audited as proposed, but the Headquarters component should be reconfigured, in collaboration with management and using a risk-based approach. The Headquarters component has been reviewed with management, the plan has been adjusted accordingly and the results have been discussed with the Audit Committee.
 - iv. OSD should initiate an external quality assessment during the first quarter of 2006 to provide itself, the Audit Committee and management with assurance that it operates in compliance with international professional standards. It is now a requirement of international standards that such external assessments are conducted at least every five years. OSD has set this review in motion.
- 4.2.4 While acknowledging the usefulness of the internal auditing work, we believe that these interventions should result in audit efforts that are more sharply focused on major risks, are considered in collaboration with management, and are more in line with international best practice and professional standards.
- 4.2.5 Once the new Charter has been approved, the 2006–2007 Audit Plan based on risk assessment has been presented, and the results of the external quality assessment are known, the Audit Committee will be better placed to assess whether or not:
- i. the level of assurance desired by the Executive Director is appropriate;
 - ii. the level of audit activity proposed will provide this assurance;
 - iii. the resources available will be sufficient to deliver the audit activities proposed; in this regard, we note that the resources for this function were substantially increased for the current biennium; and
 - iv. the function is in compliance with professional standards.

5. Going Forward

- 5.1 The new Audit Committee has been operating for a year. It has a clear mandate, which is being tested for robustness and effectiveness. It interacts with the Executive Director, and will interact with the other oversight bodies in due course. This should provide greater opportunity to assess whether and to what extent the committee's activities and mandate strengthen the governance oversight of WFP as a whole.
- 5.2 Its focus is risk-based. It will explore with management, the external auditors, OSDA, and the inspection and investigations unit what these risks are, how they are handled and what exposure WFP faces as a result. Links with both the external and the internal auditors and with the inspections and investigations unit will be strengthened to promote more efficient and effective audit work generally.
- 5.3 The Audit Committee will increase its efforts to follow up on issues as they arise, a requirement for good oversight and better internal control.
- 5.4 Above all, efforts will be directed towards assisting the Executive Director to fulfil his responsibilities, as prescribed by the mandate.

6. Reporting to the Executive Board

- 6.1 As the mandate requires, the Audit Committee reported to the Executive Director with the intention that its report reach the Board for discussion at its November 2005 meetings. However, the Audit Committee has been informed that the Executive Board agenda cannot accommodate a discussion of this nature at that time.
- 6.2 In view of the significance of the Audit Committee's role in internal governance, a subject of interest to the Board, the committee has requested that this report be distributed to the Board for information and has recommended to the Secretariat that its second report be presented by the Chairperson at the Board's 2006 Annual Session. All of this will be done through the Office of the Executive Director.

J. Graham Joscelyne, Chairperson

29 August 2005

ANNEX I

Executive Director's Circular

(Oversight Services Division)

Date: 06/07/2004
 Circular No.: ED2004/003
 Revises:
 Amends: ED2000/03
 Supersedes:

Composition of the WFP Audit Committee

Introduction and purpose of the Circular

1. The purpose of this Circular is to amend the composition of the Audit Committee, which will provide support and objective advice to me in monitoring the corporate governance and control systems of the Programme.

Background

2. The internal oversight and audit function is a major tool for the continued guarantee of the integrity of the financial statements and the transparent and efficient management of the Programme. The Executive Board in October 2003, following its review of a paper on Best Practices in Oversight Mechanisms, recognized that WFP had an opportunity to become a leader in corporate governance in the United Nations system by adopting the best practices outlined, including a review of the arrangements in place for the WFP Audit Committee. In May 2004, the Executive Board, after consultation with the Bureau of the Board and the Steering Group on Governance, welcomed my proposal for an Audit Committee comprised of a majority of external and financial-expert members, and chaired by an external member.

Composition

3. With immediate effect, the composition of the Audit Committee is as follows:

Chairperson	Mr. Graham Joscelyne
External Members	Ms. Jessie Rose Degala-Mabutas
	Mr. John Parsons
Internal Members (in a personal capacity)	Mr. Michael Stayton
	Ms. Diana Serrano
Secretary	Ms. Helen Hall-Chintedza (Alternate: Mr. Anthony Tyrrell)

4. In recognition of the change in composition, the responsibilities of the Audit Committee are also being reviewed, and the revised Terms of Reference will be issued in due course.
5. The valuable services rendered by the former Chairperson, Mr. Jean-Jacques Graisse, and members, including Ms. Dianne Spearman, Mr. Jamie Wickens, Mr. Saeed Malik and Mr. Allan Jury, are very much appreciated and I thank them for their commitment and contribution to the Audit Committee.

Effective Date

6. This circular takes immediate effect.

James Morris
Executive Director

ANNEX II**Executive Director's Circular**
(Inspector-General & Oversight Services Division)

Date: 14 March 2005
Circular No.: ED2005/005
Revises:
Amends:
Supersedes: ED2000/003

Terms of Reference for the WFP Audit Committee**Purpose**

- 1) The WFP (the Programme) has established an Audit Committee to assist the Executive Director (ED) in fulfilling his responsibilities for financial reporting, use of resources, the Programme's internal control arrangements, risk management process, and other audit related matters. The Audit Committee primarily advises the ED on these matters and its purpose is not to substitute for the advisory functions provided to the Executive Board by the United Nations Advisory Committee for Administrative and Budgetary Questions (ACABQ) or the FAO Finance Committee.
- 2) To facilitate transparency and relative independence of the Audit Committee from day-to-day management, the majority of the Audit Committee members shall be external to the Programme. They should possess competence in the relevant aspects of the Programme (including finance, management and audit).
- 3) An external member will chair the Audit Committee.

Mandate

- 4) The Audit Committee shall:
 - a) Advise the ED on all issues arising from its activities under these Terms of Reference.
 - b) Review and advise the ED on policies significantly impacting accounting and financial reporting issues; use of resources and the effectiveness of the Programme's internal controls; the internal audit function; operational procedures and risk management.
 - c) Review and advise the ED on the Programme's financial statements and reports.
 - d) Promote the understanding and effectiveness of the audit function within the Programme, and provide a forum to discuss internal control and risk management issues, operational procedures and matters raised by internal and external audits.
 - e) Provide comments on the work plans of the internal and external audit functions for consideration in their ongoing review.
 - f) Consider all relevant reports by the internal and external auditors, including reports on the Programme's financial statements and management letter. The Programme is responsible for the fair presentation of financial statements including adequate disclosure.

- g) Consider the risk and control implications of reports from OSDI in terms of its mandate and refer audit issues to the investigations unit as appropriate, with regard to due process and privacy considerations.
- h) Monitor the implementation of the internal and external audit recommendations;
- i) Review and advise the ED on the Programme's arrangements for its employees and external parties to raise concerns, in confidence, about allegations of wrongdoing in the management and conduct of operations;
- j) Prepare an annual report on its activities for the ED and for transmission for information purposes to the Board.
- k) Make appropriate recommendations to the Executive Director.

Access

- 5) The Audit Committee has the authority to:
 - a) Obtain all information and/or documents it considers necessary to perform its mandate including all audit reports and audit work papers produced by internal audit.
 - b) Seek any information from any employee or request information generated from the Programme's systems and require all employees to cooperate with any request made by the Audit Committee in performing its mandate.
 - c) Obtain legal or other independent professional advice if it is considered necessary.
- 6) The Chairman and the External Auditor will meet annually in private session.

Number of meetings

- 7) The Audit Committee shall normally meet at least four times a year. The Chairman, any Member and the External Auditor may request additional meetings.

Convocation of meetings

- 8) The meetings of the Audit Committee shall be convened by the Chairman or by the Secretariat on the instruction of the Chairman. The members of the Audit Committee shall normally be given at least ten working days' notice of meetings.
- 9) The Chairman will prepare a provisional agenda for the meetings that should be circulated together with the invitations.

Membership & Quorum

- 10) The ED shall appoint the five members of the Audit Committee; three members will be external to the Programme and two members will be employees. An alternate cannot represent members. Any three members (of whom two will be external members) shall constitute a quorum.
- 11) Terms of office will be two years renewable once, with the renewal period phased so as to provide continuity of oversight.

Conflicts of Interest

- 12) A register of interests will be kept to record members' interests in general or on specific matters. Where an actual or potential conflict of interest arises, the interest will be declared and will cause the member/s to either be excused from the discussion or abstain from voting on the matter. In such event, a quorum would be required from the remaining members.

Responsibility and Liability of Members

- 13) Members shall act in an independent, non-executive capacity while performing their advisory role on the Audit Committee. As such, members shall not be held personally liable for decisions taken by the Audit Committee acting as a whole.

Participation other than in Person

- 14) It is expected that members will be present for meetings. Members may also attend by video conference. However, should a member attend by telephone, they will not be taken into account for the purposes of establishing a quorum.

Attendance

- 15) The Executive Director is invited to all meetings.
- 16) The External Auditor, the Deputy Executive Director for Administration, the Director of Oversight, and the Director of Internal Audit shall also normally be present. The Audit Committee may decide to hold "executive sessions" without their presence from time to time as determined by the Chairman.

Acting Chairman

- 17) If the Chairman is unable to attend a meeting, the Members present shall elect an Acting Chairman for that meeting from among the external members present.

Voting

- 18) The Audit Committee's decisions are taken by the majority of the members present and voting. Should the votes be equally divided, the Chairman shall have the casting vote.

Secretariat function

- 19) The Secretariat function for the Audit Committee shall be carried out by a member of the Programme's staff designated by the ED, and will report directly to the Chairman on matters relating to the work of the Audit Committee.

Minutes

- 20) Minutes of meetings will be prepared and kept by the Secretariat. The Audit Committee shall approve the minutes by correspondence, within a month of the meeting.
- 21) Supporting documents will be prepared by the Chairman or by the Secretariat on the instruction of the Chairman or on their own initiative. Documents may also be submitted by the External Auditor or, with the approval of the Chairman, by other management steering committees e.g. the Investment Committee.

Confidentiality of meetings and Minutes

- 22) The deliberations of the Audit Committee and the minutes of the meetings are confidential unless otherwise decided. The documents and informational material circulated for the consideration of the Audit Committee shall be used solely for that purpose and treated as confidential.

Reporting

- 23) The Audit Committee shall prepare a report on its work for the previous year for presentation to the ED during the first calendar quarter. It will include recommendations with respect to changes to its mandate. The Audit Committee will also prepare a report for the annual session of the Executive Board in May each year. The Chairman shall present these reports.
- 24) The chairman will interact regularly with the ED on the results of Audit Committee deliberations as well as on forthcoming issues relevant to its business.

Indemnity of Members

- 25) Audit Committee members are indemnified from actions taken against them as a result of activities performed in the course of business of the Audit Committee, as long as such activities were performed in good faith.

James Morris
Executive Director