

Internal Audit of WFP's Management of its Investment Portfolio

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World Food Programme



Contents

	Page
I. Executive Summary	3
II. Context and Scope	5
III. Results of the Audit	8
Annex A – Summary of Categorization of Observations	14
Annex B – Definition of Audit Terms	15
Annex C – Acronyms	18

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I. Executive Summary

Introduction

1. As part of its annual work plan, the Office of Internal Audit conducted an audit of WFP Headquarter's management of its investment portfolio, with specific focus on corporate issues. The audit covered the period from 1 January 2015 to 30 September 2016 and looked at events prior and subsequent to this period, as required. The audit team conducted the fieldwork from 17 October 2016 to 18 November 2016. This work was carried out at WFP's Headquarters in Rome and included the review of internally and externally managed portfolios, monitoring and reporting mechanisms, selection and monitoring of external investment managers, as well as the management of counterparty, market and operational risks.

2. WFP assumed full responsibility for managing its cash resources on 1 January 1999. Prior to that date, investments were managed by the Food and Agriculture Organization. The overarching objective of WFP's investment management is to ensure that "monies not required immediately may be invested by the Executive Director, bearing in mind the need for safety, liquidity and profitability". All funds in the Liquidity Portfolio need to be invested so as to ensure that there is "no probability of negative total return of the portfolio over the investment horizon".

3. The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

Audit Conclusions

4. The audit observed that, taking into consideration that the primary objective of the investment policy is the preservation of the value of resources, no significant issues, strictly related to the investment process, have been identified, according to WFP's mission and objectives. However, the processes in place present room for improvement with regards to operational and monitoring aspects.

5. The audit revealed that significant attention and effort was placed on the following¹: clear definition of investments' objective and risk tolerance, as well as strategic asset allocation through the introduction of Investment Policies and related investment guidelines; awareness of the risk related to the in-house portfolio resulting from prior advisory work from the Office of Internal Audit in 2014; more accurate reporting through the improvement of the Treasury Management Report, reviewed quarterly by the Investment Committee that performs a strategic advisory and monitoring role for the Executive Director; increase of expertise to contribute to the investment management via the technical advisory services provided by the World Bank and the establishment of an Investment Advisory Panel.

6. The audit noted that the investment balances currently managed have reached an all-time high volume, totalling USD 2,742 million, as of 30 September 2016. This may be a structural change due to the overall increase in WFP's volumes and the spike in large level 3 corporate emergencies. Considering the combined effect of this increase of financial assets, the complexity of business activities and the volatile market conditions, the audit highlighted areas that may be improved for a more effective and efficient management of investments. Therefore, it is recommended to perform a periodic revision of the investment policies following a previously defined Risk Appetite Framework (RAF). In addition, a further level of analysis may include the assessment of the level of liquidity to meet short-term obligations versus the long-term assets.

¹ For further details, see Table 2: Positive practices and initiatives.






7. The audit also noted unmitigated risks, which could challenge effective Treasury management. Furthermore, some observations are linked to the decision to transfer in-house part of the funds externally managed; therefore, the assessment of the resources of the unit responsible for these investments is of the utmost importance.

8. The audit report contains observations related to aspects of governance and oversight, risk management, and internal controls. The interdependency of these issues is important to recognise; sufficient staff, clear attribution of roles and responsibilities, design and implementation of internal controls, and the assignment and execution of oversight responsibilities are all essential and mutually reliant activities in the investment process.

9. The audit of WFP's management of its investment portfolio concluded that internal controls, governance and risk management practices were generally established and functioning; nevertheless, a continuous improvement process is feasible along the lines of attribution of roles and responsibilities and clear definition of segregation of duties, especially in the light of increasing financial assets to be managed by Headquarters.

10. Based on the results of the audit, the Office of Internal Audit has come to an overall conclusion of **partially satisfactory**. Conclusions are summarised in Table 1, sub-divided by internal control component:

Table 1: Summary of risks by Internal Control Component

Internal Control Component		Risk	
1.	Control Environment	Medium	
2.	Risk Assessment	Medium	
3.	Control Activities	Medium	
4.	Information and Communication	Low	
5.	Monitoring Activities	Medium	

Audit Observations

11. The audit report contains no high-risk observations and five medium-risk observations.

Actions Agreed

12. Management has agreed to address the reported observations and work is in progress to implement the agreed actions.

13. The Office of Internal Audit would like to thank managers and staff for their assistance and cooperation during the audit.

David Johnson
Inspector General

II. Context and Scope

Investment Portfolio

14. WFP assumed full responsibility for managing its cash resources on 1 January 1999, which led to the development of WFP's investment policy and cash and investment management strategies. The management of financial resources is governed by Financial Regulation 11.2 that states: "Monies not required immediately may be invested by the Executive Director (ED), bearing in mind the need for safety, liquidity and profitability". In line with Financial Rule 111.4, the Executive Director issues investment policy circulars from time to time and may employ outside expertise.

15. WFP uses a global custodian bank that provides safe keeping of securities with its network of sub-custodians and depositories. Securities trade settlement and interest collection are also processed through the custodian. Other important services include monthly valuations and accounting reports, performance and risk measurement, compliance monitoring as well as other ancillary services like money market funds.

16. Since February 2000, WFP has used external investment managers for its short-term investment portfolio and the long-term Employee Benefit Fund (EBF) portfolio. They are appointed after a competitive selection process and operate under strict guidelines. Four investment managers currently manage the short-term investment portfolio, whilst the EBF portfolio is entrusted to two investment managers.

17. In May 2012, the Executive Director approved the transfer of part of its investments from holdings in externally-managed money market funds to in-house management, setting a maximum ceiling of USD 100 million. Subsequently, in 2013, the Investment Committee approved a request from the Treasury Branch (RMFT) to increase the value of the in-house managed part of the working capital portfolio ("P0 portfolio") from USD 100 million to USD 300 million.

18. The liquidity portfolio comprises cash balances related to programme category funds, bilateral operations and trust funds, and the General Fund and special accounts. The primary objective of the investment policy for this portfolio is the preservation of the value of resources in USD terms. The main considerations for investment management are the security of principal, liquidity and rate of return, in line with Financial Regulation 11.2. To make the best use of WFP's risk-bearing capacity and to add value, the liquidity portfolio is separated into three tranches with different investment timeframes:

- The working capital portfolio ("P0") shall comprise of working capital funds, which may be required in the near term by the Programme;
- The short-term portfolio ("P1") shall comprise of other operational funds with a short or uncertain cash-flow profile;
- The medium-term portfolio ("P2") shall comprise of funds that are not expected to be drawn down, on average, over a period of less than one year.

19. P0 is invested in time deposits, an AAA rated money market portfolio managed in-house, and a USD denominated money market fund that invests in securities issued or guaranteed as to principal and interest by the United States Government. WFP holds a participation in the money market fund, which can be accessed on a day-to-day basis. Trust fund balances are maintained in P0. The P1 investment tranche is managed by two external investment managers as is the P2 investment tranche. The most recent investment management mandates were issued in January 2014, following the competitive selection of all four managers.

20. The EBF represents funds set aside to cover long-term employee benefits liabilities that consist of the After-Service Medical Plan, Separation Payments Scheme, Compensation Plan Reserve Fund and Other Separation Related Benefits. Investments in the EBF portfolio are guided by a specific investment policy, mandates and guidelines, which were reviewed by the Investment Advisory Panel members, endorsed by the Investment Committee and approved by the Executive Director in 2011. The EBF portfolio is made up of two portfolios, an actively-managed bond portfolio and a passive equity portfolio. The bond portfolio equates to 49.95 percent of the EBF

portfolio, with the remaining 50.05 percent invested in six regional equity index funds, managed by external investment managers. The asset allocation policy is to maintain an equal allocation to both asset classes.

21. The aforementioned types of portfolios and tranches, each with a different investment horizon and level of liquidity, are detailed below in Figure 1: "Cash and Investments Position". The composition of the tranches is decided by the Executive Director, based on recommendations made by the Investment Committee. The level of investment within each tranche and up to the maximum approved ceiling is decided by RMFT.

Figure 1: Cash and Investments Position

Portfolio Tranche	Investment Horizon	Benchmark	Max. Ceiling	Value as at 30 September 2016
P0 Working capital portfolio	3 months	USD T-Bill 0-3 month index	USD 400 million (of which USD 300 max managed in-house)	USD 398 million
P1 2 Short-term portfolios	6 months	USD T-Bill 3 month index	No specific ceiling – what is not specifically allocated to P0 or P2	USD 1,121 million
P2 2 Medium-term portfolios	18 months	Bank of America/ Merrill Lynch US Treasuries 3 year index	USD 500 million	USD 505 million
a) Total Liquidity Portfolio				USD 2,024 million (74%)
Global Bond		Barclays Capital Global Aggregate		USD 225 million
Global Equity		MSCI All-Country World		USD 226 million
b) Total Employee Benefit Fund Portfolio				USD 451 million (16%)
c) HQ cash				USD 106 million (4%)
d) Field cash				USD 74 million (3%)
e) US Treasury Strips				USD 88 million (3%)
Total Cash and Investments Position of WFP (a+b+c+d+e)				USD 2,742 million (100%)

22. The Investment Committee was created in September 1999 in order to provide a strategic advisory and monitoring role to the Executive Director. Its mandate was last renewed in February 2016 to reflect the appointment of three new members. The mandate of the Investment Committee is to make recommendations to the Executive Director on the formulation and implementation of policy and strategy regarding investment management, Foreign Exchange (FX) management and the use of financial service providers.

23. Since May 2015, the Treasury Management Reports are issued quarterly by RMFT, following the Finance and Treasury Division's (RMF) decision to reduce the frequency of the reporting from monthly, due to capacity constraints. Nevertheless, RMFT continues to provide, on a monthly basis, to the Investment Committee and senior management a highlight section of the Treasury Management Report, the in-house portfolio sections with the related compliance checks performed by the General Accounts Branch (RMFG), and any other critical issues. Specifically, the Investment Committee members, ex-officio members, Deputy Executive Director, and Assistant Executive Directors (AED) receive, via e-mail on a monthly basis, the "Investment Performance Report & Market Commentary" prepared by the Director RMF, corresponding to section 2.1 of the Monthly Treasury Management Report.

RMFT also prepares an "Annual Report on WFP Investment Management" for the Executive Director, Investment Committee members, Assistant Executive Director for Resource



Management and Chief Financial Officer. This report is also reviewed by the Audit Committee prior to submission to the Executive Director.

Objective and Scope of the Audit

24. The purpose of this assignment was to evaluate and test the adequacy and effectiveness of the processes associated with internal control components over WFP's investment portfolio management, with a specific focus on corporate issues. Such audits are part of the process of providing an annual and overall assurance statement to the Executive Director on governance, risk-management and internal control processes.

25. The audit was carried out in conformance with the *Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing*. It was completed according to an approved engagement plan and took into consideration the risk assessment exercise carried out prior to the audit.

26. The scope of the audit covered WFP's investment management from 1 January 2015 to 30 September 2016 and encompassed activities related to both the internally and externally managed portfolio. Where necessary, transactions and events pertaining to other periods were reviewed. The audit assessed the relevant controls in place, including those that RMF implemented following OIGA's review of the internally-managed working capital portfolio in 2014. The audit fieldwork took place in Rome, at WFP Headquarters (HQ), and involved three different divisions.

III. Results of the Audit

27. In performing the audit, the following positive practices and initiatives were noted:

Table 2: Positive practices and initiatives

Control Environment

- WFP has a robust investment policy framework, based on best practices, periodically reviewed with the World Bank in order to provide a clear view of the investment objectives and risk tolerance as well as the definition of the strategic asset allocation. Specifically, WFP's investment policy is developed pursuant to Financial Regulation 11.2 and sets out the principles and broad parameters of investment of funds donated and/or entrusted to WFP, which are not immediately required in programme implementation. Moreover, the Investment Committee is instructed to ensure that the appropriate operational procedures and guidelines are prepared and approved in line with the investment policy.
- Rules and principles stated in the policies are reflected more in-depth in the investment guidelines, which are detailed instructions to be followed to perform the investments. Lastly, the respect of the guidelines is constantly monitored, mainly via the custodian bank systems which promptly inform WFP about any breaches.

Risk Assessment

- Specific evaluation reports document the official assessment process for the selection of all external investment managers and the global bond provider. The competitive selection was structured in two phases: Request for Information (RFI) to review quantitative performance and risk data and a comprehensive Request for Proposal (RFP) process, as per regular procurement procedures. It was reported that all recommended managers passed a technical assessment before their financial proposals were considered by the evaluation panel. Lastly, the aforementioned selection process and recommendations were presented to and endorsed by the Investment Committee.
- Following the decision to transfer some P0 investments from external to in-house management, initially up to a maximum ceiling of USD 100 million, then increased to USD 300 million in 2014, WFP carried out an advisory review to obtain reassurance on the management of certain key risks related to the in-house management of the funds.

Information and Communication

- Since 2004, WFP has availed of the services of the World Bank to obtain technical advisory services in the areas of investment management and related activities. Additionally, in 2010, an Investment Advisory Panel was introduced, which is a panel of external experts that advises the Executive Director and Investment Committee regarding the investment management and related Treasury management issues.
- Improvement in reporting and monitoring activities has been achieved through the enhancement of the main tool in place, namely the Treasury Management Report, which has introduced an in-house investments compliance check. Moreover, the report provides an overview of all the main risk exposures and description of breaches that occurred, and it is reviewed quarterly by the Investment Committee.

28. Having evaluated and tested the controls in place, the Office of Internal Audit has come to the following conclusions on the residual risk related to the processes examined:

Table 3: Conclusions on risk, by Internal Control Component and Business Process

Internal Control Component/Business Process	Risk
1. Control Environment	
Governance relating to Investment Portfolio Management ²	Medium
Enterprise Resource Planning System in Investments Process	Low
2. Risk Assessment	
Assessment of Financial Service Providers	Low
Monitoring of Financial Service Providers	Medium
3. Control Activities	
Payments and Systems	Medium
Investments Process	Medium
4. Information and Communication	
Reporting System for Investment Management	Low
5. Monitoring Activities	
System of Monitoring	Medium
Oversight Role for Investment Management	Medium

29. Based on the results of the audit, the Office of Internal Audit has come to an overall conclusion of **partially satisfactory**³.

30. The audit made no high-risk observations and five medium-risk observations arose from the audit, which are presented in Table 4 below.

Action agreed

31. Management has agreed to take measures to address the reported observations. Work is in progress to implement the agreed actions⁴.

² For details, please refer to governance issues raised in "Table 4: Summary of medium-risk observations" (Observation 1) of the report "Internal Audit of WFP's Management of Treasury Operations" (AR/17/06).

³ See Annex B for definitions of audit terms.

⁴ Implementation will be verified through the Office of Internal Audit's standard system for monitoring agreed actions.

Table 4: Summary of medium-risk observations

Observation	Agreed action
<p>1 Risk Assessment – Monitoring of Financial Service Providers</p> <p>The audit noted that the monitoring activity of external investment managers is generally regulated by the WFP Financial Resource Management Manual. Nevertheless, the aforementioned procedure has not been updated following the “Investment Committee Annual Work Plan” for 2015 and 2016, approved by the Investment Committee on March 30, 2015 and March 15, 2016, respectively. These report the decision to alternate the investment managers subject to due diligence visits and the investment managers that will visit WFP HQ to present to the Investment Committee. Specifically, the procedure in place foresees that: “WFP performs annual due diligence visits to all its investment managers”.</p> <p>Moreover, it was detected that the monitoring activity currently performed is not compliant with the “Investment Committee Annual Work Plan” for 2015. There are no minutes of the Investment Committee meeting held in Q4 2015, in which two investment managers made presentations, because the committee met informally on that occasion due to a lack of quorum.</p> <p>Lastly and more importantly, the audit revealed that the current practices in place do not ensure the re-performing check of the qualifications/requisites for which the investment managers were initially selected, since the monitoring activity is mainly focused on the investments performance. However, it was noted that, following this observation, RMFT has introduced, starting from November 2016, an objective checklist to perform their monitoring activities of the external investment managers during their due diligence visits.</p> <p><u>Underlying Cause:</u> <i>Compliance</i> - Requirement to comply with prescribed WFP regulations, rules and procedures. <i>Guidelines</i> - Need for improvement in written policies, procedures or tools to guide staff in the performance of their functions. <i>Best practice</i> - Opportunity to improve in order to reach recognised best practice.</p>	<p>RMFT will:</p> <ul style="list-style-type: none"> (i) Update the WFP Financial Resource Management Manual Section 11: “Cash and Treasury Management” (par. 11.16.6 “Risk management, investment monitoring and compliance”) in order to reflect the new practice of annual due diligence of external investment managers (that is, alternating visits and presentations at WFP HQ); and (ii) Ensure that the newly introduced checklist to perform the ongoing monitoring activities of external investment managers is reflected in WFP procedures. It should also be regularly reviewed and approved by the Investment Committee.

Observation	Agreed action
<p>2 Control Activities – Payments and Systems</p> <p>With regards to the payment process of fees to the external investment managers, there is a lack of segregation of duties, since the officer in charge of checking an invoice's correctness, also authorises the related payment.</p> <p>Moreover, since the payments are directly executed through the Electronic Payment System (EPS), not following the usual payment cycle (that is, no involvement of the Accounts Payable Branch (RMFA)), it is important to note that the accounting of these payments is also performed by RMFT or a residual part (e.g. EBF portfolio) by RMFG, which does not verify the correctness of the invoiced amount. This could lead to potential fraud and operational risks in the process, since bank reconciliations performed by RMFG would not detect possible extra amounts paid. The total amount of fees paid to the external investment managers in 2015 and 2016 (first three quarters) was USD 1.51 million and USD 1.20 million, respectively.</p> <p><u>Underlying Cause:</u> <i>Compliance</i> - Requirement to comply with prescribed WFP regulations, rules, and procedures. <i>Resources</i> - Need for more resources (for example, funds, skills, staff) to carry out an activity or function.</p>	<p>RMFT will ensure that the payment process of fees to the external investment managers respects the principle of segregation of duties. It will guarantee that the check of the correctness of the invoice data is carried out by a separate unit/ branch, different from the authoriser. Specifically, ensure that the payment of the fees of the investment managers follows the usual payment cycle process, applying the same procedures to avoid potential fraud and operational risks.</p>

Observation	Agreed action
<p>3 Control Activities – Investments Process</p> <p>The audit noted that the investments process, related to the in-house portfolio, is not sufficiently structured. Specifically, Directive No. FP2014/001: “In-house management of working capital portfolio (P0)” does not foresee sufficient segregation of duties in the “overview of procedural steps for in-house management of P0”. In fact, with reference to all the investments selected, it was verified that the relevant steps of the process (investment selection and trade execution) are solely performed by the RMFT Chief; therefore, the principle of segregation of duties is not respected.</p> <p>According to the abovementioned directive, the involvement of the RMF Treasurer and Deputy Director is foreseen as a “same-day post-trade compliance” control; therefore this RMF approval is more of an ex-post monitoring than a joint approval. RMF has reasoned that should two authorisations be required, treasury activities would be slowed down and flexibility limited. Nevertheless, it is important to highlight that these controls will not reduce the immediate risk to WFP, as the organization is committed to execute the transaction after the first authorisation. Moreover, the audit noted that, for all the investments selected, the post-trade control was not carried out on the same day, but rather between one to five days later.</p> <p>Lastly, the strategy in place, to ensure that investment commitments do not interfere with the required cashflows and that sufficient working funds are maintained, relies on the P0 balance. Specifically, the P0 is considered a buffer used to cover daily expenditures, since the investments in this tranche are regarded as liquidity. However, the audit verified that no documented methodology has been defined for the investments forecast analysis and the evaluation of the investment decisions.</p> <p>As for the composition of the Investment Advisory Panel, it was verified that, during the audit period, the Ethics Office was not involved in the assessment of conflicts of interest of each member. It was also noted that a member of the panel covered a position in an organization that is a partner of WFP, resulting in potential conflicts of interest. In addition, the ED Decision Memorandum: “Establishment of WFP Investment Advisory Panel”, issued on 27 July 2010, indicates that: “the members of the panel will serve in their personal capacity [...]. Any potential conflict of interest has been avoided in the selection of panel members and will be reconfirmed at each meeting”. However, there is no evidence that the absence of conflicts of interest was verified in the fourth annual meeting of WFP’s Investment Advisory Panel held on 15 June 2015 (only meeting held during the period under review). Nevertheless, it is important to highlight that, following the audit period, the aforementioned issue has been addressed by RMF interacting directly with the Director and Chief Ethics Officer and General Counsel and Director, Legal Office, for its resolution.</p> <p><u>Underlying Cause:</u> <i>Compliance</i> - Requirement to comply with prescribed WFP regulations, rules, and procedures. <i>Guidance</i> - Need for better supervision and management oversight. <i>Resources</i> - Need for more resources (for example, funds, skills, staff) to carry out an activity or function.</p>	<p>RMF will:</p> <ul style="list-style-type: none"> (i) Ensure that the investments process in place enhances the segregation of duties (for example, settlement process of the in-house investments) in order to avoid potential fraud and operational risks and prevent irregularities. At a minimum, it may be worth considering the opportunity to make this risk more explicit in the current treasury policies and procedures as well as periodically bringing it to the attention of the Investment Committee for its endorsement, taking into consideration the risk appetite of the organization; and (ii) Issue dedicated guidelines, in collaboration with the Ethics Office and Legal Office, in line with leading practices, to regulate the assessment of conflicts of interest of third parties, including the criteria to avoid the selection of advisors who cover positions in organizations that are partners/ vendors of WFP. Moreover, the Ethics Office and Legal Office should jointly develop a suitable Conflict of Interest Disclosure and Confidentiality Declaration for the Investment Advisory Panel.

Observation	Agreed action
<p>4 Monitoring Activities – System of Monitoring</p> <p>The monitoring system for treasury activities, including the investments process, is not well defined and formalised in a dedicated document; therefore, roles and responsibilities as well as activities to be performed (for example, in-house investments compliance checks) are not clearly depicted.</p> <p>With regards to the compliance monitoring of investments, it was noted that the capacity to perform the controls currently in place with RMFG could be strengthened. Firstly, the month-end asset compliance reports are prepared by RMFG based on information reported in the global custodian's statements, whilst only the exceptions (that is, lack of information in the statements) are verified through the Bloomberg report (primary source). Therefore, the same level of control in place for the externally-managed investments is not guaranteed, as foreseen in the ED Decision Memorandum: "In-house management of working capital portfolio P0 as part of the Liquidity Portfolio", issued on 15 May 2012. Furthermore, it was noted that the Bloomberg reports to perform the controls are provided monthly to RMFG by RMFT, since the former does not have direct access to the platform, which could compromise the independence of the related control.</p> <p>Secondly, the non-compliance notifications, communicated by the global custodian bank for each breach, are only sent to RMF and RMFT, which are the main actors involved in the internally managed investments. No log is kept of the non-compliance notifications received; therefore, it is not possible to have an official overview of all the breaches that occurred during a given period.</p> <p><u>Underlying Cause:</u> <i>Guidelines</i> - Need for improvement in written policies, procedures or tools to guide staff in the performance of their functions. <i>Guidance</i> - Need for better supervision and management oversight. <i>Resources</i> - Need for more resources (for example, funds, skills, staff) to carry out an activity or function. <i>Best practice</i> - opportunity to improve in order to reach recognised best practice.</p>	<p>RMFT will issue a specific procedure/ operating instructions to regulate the monitoring system for treasury activities, with specific reference to the investments process, in order to clearly define roles and responsibilities of all those involved in the process, including providing direct access by RMFG to compliance alerts from the global custodian, providing direct access by RMFG to Bloomberg system, and maintenance of a log of all non-compliance alerts with related actions taken.</p>
<p>5 Monitoring Activities – Oversight Role for Investment Management</p> <p>Mechanisms to ensure oversight of WFP's management of treasury activities, including the investments process, should be reinforced. The audit noted that an independent Risk and Compliance function (not reporting to RMF) is not present. Therefore, certain activities are not performed by an independent function to RMF, such as: compliance checks on investments, management of operational and reputational risks, supporting business units for risk management issues, ensuring oversight and overall risk monitoring to senior management.</p> <p><u>Underlying Cause:</u> <i>Guidance</i> - Need for better supervision and management oversight. <i>Resources</i> - Need for more resources (for example, funds, skills, staff) to carry out an activity or function. <i>Best practice</i> - Opportunity to improve in order to reach recognised best practice.</p>	<p>RMF will evaluate the opportunity to introduce an independent Risk and Compliance function, which could be responsible for activities including, but not limited to, the following: compliance checks on investments, management of operational and reputational risks, supporting business units for risk management issues, ensuring oversight and overall risk monitoring to senior management. At a minimum, ensure that this suggestion is periodically brought to the attention of and evaluated by the Investment Committee, taking into consideration the risk appetite of the organization.</p>

Annex A – Summary of Categorization of Observations

The following table shows the categorization, ownership and due date for all the audit observations. This data is used for macro analysis of audit findings.

Observation	ICF	Risk Categories		Underlying Cause Category	Owner	Due Date
		WFP's Management Results Dimensions	WFP's Risk Management Framework			
1 Risk Assessment Monitoring of Financial Service Providers	Operational	Partnerships	Institutional	Compliance/ Guidelines/ Best practice	RMFT	(i) 31 December 2017 (ii) 30 June 2017
2 Control Activities Payments and Systems	Operational Compliance	Processes & Systems	Institutional	Compliance/ Resources	RMFT	30 June 2017
3 Control Activities Investments Process	Operational Compliance	Processes & Systems	Institutional	Compliance/ Guidance/ Resources	RMF	(i) 31 December 2017 (ii) 31 December 2017
4 Monitoring Activities System of Monitoring	Operational Reporting	Processes & Systems	Institutional	Guidelines/ Guidance/ Resources/ Best practice	RMFT	30 June 2017
5 Monitoring Activities Oversight Role for Investment Management	Strategic	People Programmes	Programmatic Institutional	Guidance/ Resources/ Best practice	RMF	31 December 2017

Annex B – Definition of Audit Terms

1. Rating system

A 1. Internal control components and processes are rated according to the degree of related risk. These ratings are part of the system of evaluating the adequacy of WFP's risk management, control and governance processes. A rating of satisfactory, partially satisfactory or unsatisfactory is reported in each audit. These categories are defined as follows:

Table A.1: Rating system

Engagement rating	Definition	Assurance level
Satisfactory	Internal controls, governance and risk management practices are adequately established and functioning well. No issues were identified that would significantly affect the achievement of the objectives of the audited entity.	Reasonable assurance can be provided.
Partially Satisfactory	Internal controls, governance and risk management practices are generally established and functioning, but need improvement. One or several issues were identified that may negatively affect the achievement of the objectives of the audited entity.	Reasonable assurance is at risk.
Unsatisfactory	Internal controls, governance and risk management practices are either not established or not functioning well. The issues identified were such that the achievement of the overall objectives of the audited entity could be seriously compromised.	Reasonable assurance cannot be provided.

2. Risk categorization of audit observations

A 2. Audit observations are categorized by impact or importance (high, medium or low risk) as shown in Table A.4 below. Typically audit observations can be viewed on two levels: (1) observations that are specific to an office, unit or division; and (2) observations that may relate to a broader policy, process or corporate decision and may have broad impact.⁵

Table A.2: Categorization of observations by impact or importance

High risk	Issues or areas arising relating to important matters that are material to the system of internal control. The matters observed might be the cause of non-achievement of a corporate objective, or result in exposure to unmitigated risk that could highly impact corporate objectives.
Medium risk	Issues or areas arising related to issues that significantly affect controls but may not require immediate action. The matters observed may cause the non-achievement of a business objective, or result in exposure to unmitigated risk that could have an impact on the objectives of the business unit.
Low risk	Issues or areas arising that would, if corrected, improve internal controls in general. The observations identified are for best practices as opposed to weaknesses that prevent the meeting of systems and business objectives.

⁵ An audit observation of high risk to the audited entity may be of low risk to WFP as a whole; conversely, an observation of critical importance to WFP may have a low impact on a specific entity, but have a high impact globally.

A 3. Low-risk observations, if any, are communicated by the audit team directly to management and are not included in this report.

3. WFP's Internal Control Framework

A 4. WFP's Internal Control Framework follows principles from the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Integrated Internal Control Framework, adapted to meet WFP's operational environment and structure. The framework was formally defined in 2011 and revised in 2015.

A 5. WFP defines internal control as: "a process, effected by WFP's Executive Board, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, compliance"⁶. WFP recognises five interrelated components (ICF components) of internal control, all of which need to be in place and integrated for them to be effective across the above three areas of internal control objectives.

Table A.3: Interrelated Components of Internal Control recognised by WFP

1	Control Environment:	Sets the tone of the organization and shapes personnel's understanding of internal control.
2	Risk Assessment:	Identifies and analyses risks to the achievement of WFP's objectives through a dynamic and iterative process.
3	Control Activities:	Ensure that necessary actions are taken to address risks to the achievement of WFP's objectives.
4	Information and Communication:	Allows pertinent information on WFP's activities to be identified, captured and communicated in a form and timeframe that enables people to carry out their internal control responsibilities.
5	Monitoring Activities:	Enable internal control systems to be monitored to assess the systems' performance over time and to ensure that internal control continues to operate effectively.

4. Risk categories

A 6. The Office of Internal Audit evaluates WFP's internal controls, governance and risk management processes, in order to reach an annual and overall assurance on these processes in the following categories:

Table A.4: Categories of risk – based on COSO frameworks and the Standards of the Institute of Internal Auditors

1	Strategic:	Achievement of the organization's strategic objectives.
2	Operational:	Effectiveness and efficiency of operations and programmes including safeguarding of assets.
3	Compliance:	Compliance with laws, regulations, policies, procedures and contracts.
4	Reporting:	Reliability and integrity of financial and operational information.

A 7. In order to facilitate linkages with WFP's performance and risk management frameworks, the Office of Internal Audit maps assurance to the following two frameworks:

Table A.5: Categories of risk – WFP's Management Results Dimensions

1	People:	Effective staff learning and skill development – Engaged workforce supported by capable leaders promoting a culture of commitment, communication & accountability – Appropriately planned workforce – Effective talent acquisition and management.
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⁶ OED 2015/016 para.7

2 Partnerships:	Strategic and operational partnerships fostered – Partnership objectives achieved – UN system coherence and effectiveness improved – Effective governance of WFP is facilitated.
3 Processes & Systems:	High quality programme design and timely approval – Cost efficient supply chain enabling timely delivery of food assistance – Streamlined and effective business processes and systems – Conducive platforms for learning, sharing and innovation.
4 Programmes:	Appropriate and evidence based programme responses – Alignment with government priorities and strengthened national capacities – Lessons learned and innovations mainstreamed – Effective communication of programme results and advocacy.
5 Accountability & Funding:	Predictable, timely and flexible resources obtained – Strategic transparent and efficient allocation of resources – Accountability frameworks utilized – Effective management of resources demonstrated.

Table A.6: Categories of risk – WFP’s Risk Management Framework

1 Contextual:	External to WFP: political, economic, environmental, state failure, conflict and humanitarian crisis.
2 Programmatic:	Failure to meet programme objectives and/or potential harm caused to others through interventions.
3 Institutional:	Internal to WFP: fiduciary failure, reputational loss and financial loss through corruption.

5. Causes or sources of audit observations

A 8. Audit observations are broken down into categories based on causes or sources:

Table A.7: Categories of causes or sources

1 Compliance	Requirement to comply with prescribed WFP regulations, rules and procedures.
2 Guidelines	Need for improvement in written policies, procedures or tools to guide staff in the performance of their functions.
3 Guidance	Need for better supervision and management oversight.
4 Resources	Need for more resources (for example, funds, skills, staff) to carry out an activity or function.
5 Human error	Mistakes committed by staff entrusted to perform assigned functions.
6 Best practice	Opportunity to improve in order to reach recognised best practice.

6. Monitoring the implementation of agreed actions

A 9. The Office of Internal Audit tracks all medium and high-risk observations. Implementation of agreed actions is verified through the Office of Internal Audit’s system for the monitoring of the implementation of agreed actions. The purpose of this monitoring system is to ensure management actions are effectively implemented within the agreed timeframe so as to manage and mitigate the associated risks identified, thereby contributing to the improvement of WFP’s operations.

Annex C – Acronyms

AED	Assistant Executive Director
COSO	Committee of Sponsoring Organizations of the Treadway Commission
EBF	Employee Benefit Fund
ED	Executive Director
EPS	Electronic Payment Systems
FRMM	Financial Resource Management Manual
ICF	Internal Control Framework
IIA	Institute of Internal Auditors
HQ	Headquarters
OED	Office of the Executive Director
OIGA	Office of Internal Audit
P0	Working Capital Portfolio
P1	Short-term Portfolio
P2	Medium-term Portfolio
RAF	Risk Appetite Framework
RMF	Finance and Treasury Division
RMFA	Accounts Payable Branch
RMFG	General Accounts Branch
RMFT	Treasury Branch
UN	United Nations
USD	United States Dollar
WFP	World Food Programme