

September 2012



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Продовольственная и  
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организация  
Объединенных  
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Organización  
de las  
Naciones Unidas  
para la  
Alimentación y la  
Agricultura

## FINANCE COMMITTEE

**Hundred and Forty-seventh Session**

**Rome, 5 - 9 November 2012**

**Terms of Reference of the FAO Audit Committee**

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

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### EXECUTIVE SUMMARY

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

### GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Director-General seeks from the Finance Committee its advice concerning the recommended update of the Audit Committee's Terms of Reference, prior to their finalization.

#### **Draft Advice**

- **The Committee concurred with the proposed update of the Terms of Reference of the FAO Audit Committee, as agreed by the Director-General and endorsed by the Audit Committee, noting that certain changes: (a) are consequent to the actions already implemented under the Immediate Plan of Action; (b) rebalance the described scope of work of the Committee to better reflect its value to the Organization; and (c) more fully document the established operating mode of the Committee.**

## Introduction

1. The Terms of Reference (ToRs) of the FAO Audit Committee are promulgated as Appendix C of Manual Section 146 – Internal Committees or Activities. The Audit Committee was established in 2003 and until 2008 comprised both internal and external members. Pursuant to a recommendation of the Independent External Evaluation, and anticipating the Immediate Plan of Action item 2.92, the membership became fully external from January 1, 2008. The functions of the Committee, as set out in its current ToRs, are based on those approved by the Director-General in 2003. Revisions to the ToRs since 2003 primarily related to the composition and size of the Committee’s membership.

2. The Audit Committee has reviewed the current ToRs over several recent meetings and identified a need for update in several respects. The 2010 and 2011 annual reports of the Audit Committee recommended that the Organization give attention to this. The Director-General concurs and agreed, in his comments to the Finance Committee on the 2011 annual report, that the proposed updates will be reviewed in conjunction with the results of the 2012 external quality assurance review of OIG’s audit activity, in time for consideration by the Finance Committee at its Autumn 2012 session.

### Reference Points for the Analysis of the Current Terms of Reference

3. IPA action 2.92 provides that the membership is fully external agreed by the Council on the recommendation of the Director-General and the Finance Committee. IPA action 2.93 provides that the Audit Committee present an annual report to the Council through the Finance Committee. The IPA action concerning the agreement of membership by Council on the recommendation of the Director-General and the Finance Committee, now implemented with new appointments and extensions, is not reflected in the current ToRs. The proposed update will bring the ToRs into alignment with this.

4. A number of other reference points were used to formulate the current proposed update. The current ToRs were reviewed taking into account input from the 2012 external quality assurance review of OIG’s internal audit activity; the recommendations of the Joint Inspection Unit as set out in its Report on the Audit Function in the UN System and the comments thereon of the Director-General and the United Nations System Chief Executives Board<sup>1</sup>; the good practices suggested or recommended by Representatives of Internal Audit Services of the United Nations and Multilateral Institutions (RIAS) in their Position Paper “Generally Accepted Audit Committee Principles and Identified Good Practices” which was endorsed as a benchmark by the JIU; and the ToRs for other similar UN specialized agencies.

5. Where significant gaps in the Committee’s role, responsibilities and function were identified in the analysis, revisions have been proposed that are deemed appropriate and practical to fit within the framework of the Organization.

### *OIG’s 2012 Audit Quality Assurance Review*

6. The independent audit quality assurance reviewer examined the proposed updated ToRs. The reviewer recommended that the submission for the update of the Audit Committee’s Charter include an explanation of how FAO aligns with the current and 2012 proposed revisions to the International Standards for the Professional Practice of Internal Auditing<sup>2</sup> and related Definitions. These documents establish, inter alia, criteria for the reporting lines and oversight arrangements for the internal audit activities by which these can be considered sufficiently independent within their organizations. The Standards refer to the role of a “Board” and the Definition establishes flexibility in how that can be applied across the variety of private, public and intergovernmental organizations.

7. The main principle is that there should be a suitable form of reporting to and oversight from a higher governing body of an organization, independent of the executive management. The external quality assurance reviewer, the Inspector-General and the Audit Committee agreed that the Audit

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<sup>1</sup> CL144/INF/9.

<sup>2</sup> The global professional standards followed by OIG for its internal auditing activities, in accordance with its Charter.

Committee's oversight of OIG's activities as set out in the current ToRs, taken together with the arrangements in the current ToRs and the OIG Charter for reporting by the Audit Committee and the Inspector-General to Council through the Finance Committee, meet this principle. No changes are therefore proposed to the Audit Committee's ToRs in this respect.

8. The external quality assurance reviewer did not have any additional recommendations on the proposed updated ToRs.

#### *JIU recommendations*

9. In most cases FAO was already implementing recommendations in the JIU report related to Audit Committees. The important difference in the proposed ToRs to the JIU recommendations concern the role of the Audit Committee vis-à-vis the external auditor<sup>3</sup>. In FAO's case, the review of the performance of the incumbent external auditor and proposals for selection of new external auditors, is fully within the purview of the governing bodies. The proposed update therefore does not introduce these aspects into the ToRs.

10. The ToRs maintain the existing role of the Audit Committee to review the adequacy of coordination of the internal audit activities of OIG with the external audit, and to review the external audit results in connection with providing guidance on organizational risks, internal audit coverage and management follow up of recommendations.

#### *Comparison with Good Practice within the UN System*

11. The most notable difference in the Committee's current ToRs to the RIAS guidance and the Audit Committee ToRs of other UN specialized agencies lies in the focus of the Audit Committee's mandate. The current ToRs reflected a need in the early 2000s to promote in-house acceptance of the importance and value of OIG functions, and to monitor the substantial changes in OIG's professional practices then underway. Since then, OIG has attained general alignment with international internal auditing standards and has established a dedicated investigation unit following international professional norms. The internal survey conducted as part of the 2012 quality assurance review indicated a very positive view of OIG's audit activity with client managers within the Organization. Going forward, greater value may be reaped by the Organization from its investment in the Audit Committee by using the knowledge and experience of the Audit Committee more fully on other aspects of its current remit.

12. In the proposed revised ToRs, the references to oversight of the operations of the agency's internal audit function are more evenly balanced by references to providing advice on financial reporting, internal control arrangements, and risk management processes.

13. The proposed revised ToRs also elaborate further on the operating mode of the Committee, as recommended in the RIAS guidance.

### **Proposed Updates**

14. The proposed updates, endorsed by the FAO Audit Committee and agreed by the Director-General, can therefore be grouped into three categories:

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

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<sup>3</sup> The relevant JIU recommendations are numbers 11-15.

15. The specific text changes proposed for the ToRs, and rationale for these, are shown in the annex to this document.

## PROPOSED CHANGES TO THE FAO AUDIT COMMITTEE TERMS OF REFERENCE

CURRENT TERMS OF REFERENCE		PROPOSED TERMS OF REFERENCE	COMMENTARY
1.	<u>Introduction</u>	1. <u>Purpose</u>	
1.	The Committee operates as an advisory panel to the Director-General and to the Office of the Inspector-General (AUD). Its aim is to assist the Organization in gaining house-wide acceptance of the importance and value of the internal audit, inspection and investigation functions and provide the Director-General with assurance that these functions are operating effectively and efficiently. The Committee will:	<p>1.1 The Audit Committee serves as an expert advisory panel to assist the Director-General on the internal control arrangements, risk management processes, financial reporting and internal audit, inspection and investigation functions of the Organization. The Audit Committee advises on these matters taking into consideration the Financial Rules and Regulations as well as policies and procedures applicable to FAO, and its operating environment.</p> <p>1.2 Through its reports being presented to the Finance Committee it provides information to the governing bodies in these areas.</p> <p>1.3 With regard to internal audit, inspection and investigation, the Committee operates in an advisory capacity to the Office of the Inspector-General (OIG). As such it assists the Inspector General with regard to ongoing quality of performance of the Office.</p>	<p>Change made to reflect a proposed broader advisory role of the Audit Committee, of which review of OIG operations remains key.</p> <p>Reflects the current arrangement where the focus is on advising the Director-General but with reports going to the Finance Committee.</p> <p>The AUD acronym in the old ToR is replaced with OIG throughout to reflect the approved change.</p>
i)	Appraise the adequacy and effectiveness of the internal audit services and its strategies, priorities and work plans and suggest	DELETED	Streamline the document – This is covered under the more specific Responsibilities section that follows.

	potential audit areas to address the Organization's risks;		
	ii) Review progress in the implementation of AUD's action plans which have been agreed upon; and	DELETED	Streamline the document – This is covered under the more specific Responsibilities section that follows.
	iii) Take note of the reports of the External Auditor and monitor timely follow-up of his/her recommendations.	DELETED	Streamline the document – This is covered under the more specific Responsibilities section that follows.
2.	<u>Terms of Reference</u>	2 <u>Responsibilities</u>	Section re-titled, because the whole document is titled Terms of reference.
	The Committee has the following responsibilities:	2.1 The Committee reviews and advises the Director-General on:	The responsibilities that follow this line are grouped into clusters in which some significant elements are highlighted without limiting the scope of the Committee to those elements.
		a) policies significantly affecting accounting and financial reporting issues and the Organization's financial control, including consideration of: <ul style="list-style-type: none"> <li>i) the Organization's financial statements, and the results of external audits of the financial statements as documented in the audit opinion and management letters of the external auditor;</li> <li>ii) the arrangements for the external audit of the Organization and their implementation;</li> <li>iii) the Organization's financial accounting and management policies; and the status of improvement projects concerning financial systems and financial reporting.</li> </ul>	Added in line with RIAS paper good practice example; "Oversight responsibilities include a) the integrity and appropriateness of financial and other reporting practices.
(c)	Review significant risks facing the organization	b) the Organization's internal control and risk management strategy, framework and processes, in light of the significant risks facing the organization, including	Expanded to reflect the development of enterprise risk management in FAO
(e)	Review the reports of AUD and the External Auditor (except for reports specifically		

	requested by donors), assess the implications of their findings on existing policies, systems and procedures and actively oversee and monitor the timely implementation of the audit recommendations;	<p>consideration of:</p> <ul style="list-style-type: none"> <li>i) the Organization's improvement projects concerning internal controls and risk management;</li> <li>ii) the results of internal and external audit coverage of the Organization and the status of recommendations arising from internal and external audits.</li> </ul>	
		<ul style="list-style-type: none"> <li>c) the Organization's policies to combat fraudulent, corrupt and collusive practices for its employees and external parties, including improper use of the Organizations resources, and the arrangements for employees and external parties to raise concerns, in confidence, about wrongdoing in the management and conduct of operations.</li> </ul>	Added in line with RIAS guidance. Already something subject to the AC's consideration in practice.
(a)	Ensure the independent role of the Office of the Inspector General (AUD);	<ul style="list-style-type: none"> <li>d) the effectiveness and efficiency of OIG's internal audit, inspection and investigation functions, and adherence to the Charter of the Office of the Inspector General, the Guidelines on Internal Administrative Investigations and to applicable international internal auditing and investigation standards, including consideration of: <ul style="list-style-type: none"> <li>i) the independent role of the Inspector General and his/her Office;</li> <li>ii) the sufficiency of resources available for OIG to meet the Organization's needs;</li> <li>iii) OIG's quality assurance mechanisms and results of internal and external quality assurance reviews;</li> <li>iv) the adequacy of planned and actual internal audit coverage with due regard to external audit coverage, to ensure that emphasis is</li> </ul> </li> </ul>	Consolidates in more summarized form the related items in the current ToRs relating to review of OIG.

		<p>placed by OIG on high-risk areas;</p> <p>v) audit reports issued by OIG and the status of implementation by the Organization of the recommendations;</p> <p>vi) investigation findings of presumptive or actual mismanagement, irregularities and fraud, and the status of actions by the Organization on the findings;</p> <p>vii) OIG's quarterly and annual reports.</p>	
(b)	Review and provide advice on the biennial work plans of AUD in the areas of audit and inspection;	DELETED	Combined in 2.1 d) above
(d)	Assess the effectiveness and adequacy of internal audit coverage with due regard to external audit coverage, to ensure that emphasis is placed on high-risk areas;	DELETED	Combined in 2.1 d) above
(e)	Review the reports of AUD and monitor the timely implementation of the audit recommendations;	DELETED	Combined in 2.1 d) above
(f)	Satisfy itself that AUD adheres to the international internal auditing standards adopted by the heads of audit of the United Nations, the Specialized Agencies as well as by the World Bank and other entities within the UN system;	DELETED	Combined in 2.1 d) above
(g)	Review investigation findings of presumptive or actual mismanagement, irregularities and fraud, and monitor follow-up responsibilities;	DELETED	Combined in 2.1 d) above
(h)	Review the AUD annual activity report to the Director-General subsequently provided to the Finance Committee;	DELETED	Combined in 2.1 d) above
(i)	Review the performance and effectiveness of	DELETED	Combined in 2.1 d) above

	AUD, ensuring consistency with approved plans and the Charter of the Office of the Inspector-General;		
(j)	Satisfy itself that the resources available for AUD are sufficient to meet the Organization's needs;	DELETED	Combined in 2.1 d) above
(k)	Provide advice to the Director-General and the Inspector-General as it deems appropriate; and	DELETED	Combined in 2.1 d) above
		2.2 The Committee establishes an annual plan to ensure the committee's responsibilities and stated objectives for the period are effectively addressed.	Added in line with RIAS guidance.
(l)	Submit its own annual report to the Director-General who will subsequently provide the FAO Finance Committee with a copy.	2.3 Submits an annual report on its activities for the Director-General who subsequently provides the FAO Finance Committee with a copy, together with any additional comments that the Director-General wishes to make on it.	Reflects that the Director-General may transmit the AC report to the FC with additional comments, which he has done for recent reports.
6.	<u>...and Authority</u>	<u>3 Authority</u>	
	...The Committee will have the authority to: i) Obtain all necessary information and consult directly with the Inspector-General and his/her staff ii) Access all reports and working papers produced by AUD iii) Seek any information it requires from any staff member and require all staff members to cooperate with any request made by the Committee iv) Obtain independent professional advice and secure the attendance of outside	3.1 The Audit Committee has the authority to: a) Obtain all necessary information and consult directly with the Inspector General and his/her staff b) Access all reports and working papers produced by OIG. c) Seek any information from any staff member and require all staff to cooperate with any request made by the Audit Committee. d) Obtain independent professional advice and secure the attendance of outside	No change

	persons with relevant experience and expertise if considered necessary	persons with relevant experience and expertise if it is considered necessary.	
3.	<u>Composition of Committee</u>	<u>4. Membership</u>	
	The Committee consists of five external members and a Secretary <i>ex-officio</i> . All members and the secretary are appointed by the Director-General.	4.1 The Committee consists of five external members and a Secretary <i>ex-officio</i> . All members and the secretary are appointed by the Director-General.	No change.
		4.2 The Committee membership is agreed to by the Council on the recommendation of the Director-General and Finance Committee.	Added to reflect changes which have been implemented under the Immediate Plan of Action
	Members are selected on the basis of their qualifications as senior audit and/or investigation professionals.	4.3 Members are selected on the basis of their experience and qualifications relevant to the mandate of the Committee. One or more members have senior level audit and/or investigation experience. Due regard is paid in their selection to gender and geographic representation in the Committee.	Reflects the diversity considerations in the AC membership replacement strategy agreed by the DG in October 2010.
		4.4 Members are independent of the FAO Secretariat and the Director-General. Former members of Permanent Representations to FAO or the FAO Secretariat are not appointed to the Audit Committee within a period of two years following the end of those responsibilities.	RIAS guidance refers to five year embargo on former members of management. The proposed version proposes two years and expands it to encompass former members of Permanent Representations.
		4.5 Members serve in their personal capacity and cannot be represented by alternate attendees.	
	The Committee elects its own Chairperson.	4.6 The Committee elects its own Chairperson from within their number.	Additional wording to add precision.
	The Inspector General provides secretariat services to the Committee.	DELETED	replaced by Section 5 below
	At the discretion of the Chairperson, the External Auditor may be invited to attend meetings of the	DELETED	Incorporated in 6.8 below

Audit Committee.			
4.	<u>Term of Office</u>		
	Members serve for a two-year period, which may be renewed at the discretion of the Director-General for one or more years.	4.7 Members serve for a three-year period, which may be renewed once for a further two years after the initial term, at the discretion of the Director-General. Members' terms of office are phased so as to provide continuity. Renewal is subject to a positive assessment of the member's contribution during his or her first term.	Introduces both continuity and refreshment considerations in the AC membership. A term limit of five-six years is the recommended maximum in the RIAS paper. As far as structuring the maximum term, a 3+2 formula is proposed that is in line with the RIAS guidance. Shorter (e.g. two-year) terms will require more frequent submissions to the governing bodies.
		<u>5. Secretariat</u>	
		5.1 The Secretary of the Audit Committee is the Inspector General <i>ex officio</i> , who shall report directly to the Chairperson on matters relating to the work of the Audit Committee. OIG provides Secretariat staff support.	Replaces and expands upon reference in old Section 3.
5.	<u>Meetings</u>	<u>6. Meetings</u>	
	i) At the discretion of the Chairperson, the Committee may meet three to four times each year. Additional meetings may be called by the Chairperson if deemed appropriate.	6.1 At the discretion of the Chairperson, the Committee meets at least three times a year. Additional meetings may be called by the Chairperson if deemed appropriate. The Director-General, Inspector General or External Auditor may request the Chairperson to call additional meetings if necessary.	Old 5(i) and (ii) combined and expanded.
	ii) The Inspector General has the right to request the Chairperson of the Committee to convene a meeting if necessary.	DELETED	Combined in 6.1 above.
		6.2 The members of the Audit Committee are normally be given at least ten working days' notice of meetings.	Added to confirm appropriate practice concerning committee meetings.
		6.3 The Chairperson approves a provisional	Added to confirm current and/or appropriate

	agenda for the meetings that should be circulated together with the invitations.	practice concerning committee meetings.
	6.4 Supporting documents are prepared by the Chairperson or by the Audit Committee Secretariat on the instruction of the Chairperson or on the Secretary's initiative. Documents may also be submitted by the External Auditor or, with the approval of the Chairperson, by management or other committees of the Organization. The documents and informational material circulated for the consideration of the Audit Committee are used solely for that purpose and treated as confidential.	Added to confirm current and/or appropriate practice concerning committee meetings.
iii) The presence of all five members is expected at each meeting but meetings can take place with a quorum of three members. The Secretary to the meeting (Inspector General) will have no voting rights.	6.5 The presence of all five members is expected at each meeting but meetings can take place with a quorum of three members. The Secretary to the meeting has no voting rights. The Audit Committee's decisions are usually taken by consensus but if this is not the case by the majority of the members present and voting. Should the votes be equally divided, the Chairperson has the casting vote.	Expanded
	6.6 Members may participate in a meeting by telephone or video conference link, during which time they are counted the purpose of establishing a quorum.	Added to confirm current and/or appropriate practice concerning committee meetings.
	6.7 If the Chairperson is unable to attend a meeting, the Members elects an Acting Chair for that meeting from among the members present.	Added to confirm current and/or appropriate practice concerning committee meetings.
	6.8 The Chairperson may invite OIG or other FAO staff, or the external auditor, to attend meetings.	Expands on an existing element in the ToRs in old Section 3, now moved under this heading.
	6.9 The Audit Committee may decide to meet in closed session from time to time as determined by	Added to confirm current and/or appropriate practice concerning committee meetings.

		the Committee, or in private sessions with the Secretary, with management representatives or the representative of the external auditor.	
		6.10 Minutes of meetings are prepared and kept by the Secretariat. The Audit Committee reviews the draft minutes by correspondence, and formally adopts the minutes at its next meeting.	Added to confirm current and/or appropriate practice concerning committee meetings.
		6.11 The deliberations of the Audit Committee and the minutes of its meetings are shared with the Director-General's nominated focal point to the Audit Committee, the Cabinet and with OIG staff, but are otherwise confidential unless decided by the Chairperson. The Chairperson may agree to share all or relevant parts of the minutes with other FAO senior managers, or request the Secretariat to provide summaries of decisions, for the purpose of follow up action by FAO senior managers.	Added to confirm current and/or appropriate practice concerning committee meetings.
		<u>7. Conflicts of Interest</u>	
		7.1 Prior to their appointment, new members complete a conflicts of interest declaration. Where an actual or potential conflict of interest arises, the interest is to be declared and results in the member/s being excused from the discussion or abstaining from voting on the matter. In such event, a quorum is required from the remaining members for the consideration of this matter.	Added in line with RIAS guidance.
		<u>8. Responsibilities and Liabilities of Members</u>	
		8.1 Members act in an independent, non-executive capacity while performing their advisory role on the Audit Committee. As such, members are not to be held personally liable for decisions taken by the Audit Committee acting as a whole.	Added in line with common practice for AC charters and RIAS guidance.

		8.2 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, so long as such activities were performed in good faith.	Added in line with RIAS guidance.
6.	<u>Reporting and ....</u>	<u>9. Reporting</u>	
	The Committee reports to the Director-General and all reports of the Committee will be addressed to him. The Director-General will provide a copy of the Committee's annual report to the Finance Committee, together with the Director-General's comments thereon, if any. The Chairperson or another member, as decided by the Committee, will be invited to the Finance Committee session to present the Committee's annual report.	9.1 The Committee reports to the Director-General and all reports of the Committee are addressed to him or her. The Audit Committee prepares an annual report on its work for the Director-General, which is presented to the Finance Committee each year along with any comments of the Director-General. The report includes an annual self-evaluation of the Committee's work. The Chairperson of the Audit Committee, or another member, as decided by the Committee, is invited to the Finance Committee to present the Committee's annual report.	Expanded, mainly to refer to inclusion of a self-evaluation in future annual reports.
		9.2 The Chairperson communicates with the Director-General's designated focal point on the results of the Committee's deliberations as well as on forthcoming issues relevant to its business.	Added to reflect current practice and expectations, and in line with RIAS guidance on effective communication with management.
		<u>10. Remuneration and Reimbursement of Costs</u>	
		10.1 Members are not remunerated by FAO for activities undertaken with respect to their membership of the Audit Committee. FAO reimburses Committee members for any travel and subsistence costs that are necessarily incurred in relation to participation in Committee meetings.	Added in line with RIAS guidance for AC charter to address terms and conditions of service.
		<u>11. Periodic Review of the Terms of Reference</u>	
		11.1 The Committee periodically reviews the	Added in line with RIAS guidance.

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	adequacy of its terms of reference, where appropriate recommending changes to the Director -General for approval.	
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