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AUDITED BIENNIAL ACCOUNTS (2004–2005): SECTION III

**The Audit of the Financial Statements of
the World Food Programme for 2004-2005**

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NOTE TO THE EXECUTIVE BOARD

This document is submitted for approval by 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 point indicated below, preferably well in advance of the Board's meeting.

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Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact the Supervisor, Meeting Servicing and Distribution Unit (tel.: 066513-2328).





National Audit Office

International Audit

The United Kingdom National Audit Office (NAO) provides an external audit service to the World Food Programme. The External Auditor, Sir John Bourn, Comptroller and Auditor General of the UK, has been appointed by the Executive Board in accordance with the Financial Regulations. In addition to certifying the accounts of the WFP under Article XIV of the Financial Regulations, he has authority under the mandate, to report to the Executive Board on the efficiency of financial procedures and the general administration and management of WFP.

The NAO provides external audit services to international organisations, working entirely independently of its role as the Supreme Audit Institution of the United Kingdom. The NAO has a dedicated team of professionally qualified staff with wide experience of the audit of international organisations.

The aim of the NAO's audit is to provide independent assurance to States Members and donors; to add value to the WFP's financial management and governance; and to support the objectives of the Programme's work.

Report of the External Auditor

The audit of the financial statements of the World Food Programme for 2004-2005

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EXECUTIVE SUMMARY

- *Satisfactory audit results and a clear audit opinion*
- *Summary of audit coverage*
- *Recommendations to improve financial management and governance*

Overall Results of the Audit

1. I have audited the accounts of the World Food Programme (WFP) in accordance with the Financial Regulations. The audit was conducted in accordance with the Common Auditing Standards of the Panel of External Auditors of the United Nations, the Specialized Agencies and the International Atomic Energy Agency.
2. In accordance with Article XIV of the Financial Regulations, I issue this long form report on my audit of WFP's financial statements for the biennium. Under the authority of the Additional Terms of Reference Governing External Audit appended to the Financial Regulations, my report includes observations and recommendations directed at improving WFP's financial management and control; and also reports on matters relating to the economy, efficiency, and effectiveness of the use of WFP's financial and other assets.
3. I am pleased to report that my audit revealed no weaknesses or errors that I considered material to the accuracy, completeness and validity of the accounts as a whole and I have placed an unqualified opinion on WFP's financial statements for the period 2004-2005.
4. In addition to this report, I am also presenting a report on my review of WFP's arrangements for Results Based Management.

Main Audit Findings and Recommendations

5. As part of my programme of work for the 2004-2005 Biennium, presented to the Executive Board in January 2005¹, I have already issued reports on the introduction of International Accounting Standards, the upgrade of the WINGS system, review of the Dubai Support Office and FITTEST and the reporting of post delivery food losses.
6. During the biennium my staff carried out audit visits to WFP offices and operations in 19 countries, including the six regional bureaux, as noted at Annex 1 to this report. We have delivered 19 management letters as reports to management and the Audit Committee concerning financial management and the operations of the organisation.

¹ WFP/EB.1/2005/5-D.

7. This present report sets out the scope and approach of my financial audit for 2004-2005; detailed findings from that work; and comments on follow up to the 2002-2003 External Auditor's report. The detailed findings presented further below set out the most significant issues with recommendations for action which arise from the work carried out by my staff at headquarters and in their visits to the six regional bureaux and 13 country offices.
8. Following the Programme's welcome decision to improve its financial reporting by working towards compliance with international accounting standards, significant effort has been required to ensure more robust and transparent financial information, in a biennium when the WFP's Information Network and Global System, WINGS, was operational on a worldwide basis for the first time. To support the efforts being made by the Secretariat to achieve improvements in the quality and reliability of the Programme's accounting and financial reporting, I have made ten recommendations directed towards:
 - Improvements to governance and internal oversight;
 - The establishment of a sound level of financial controls on commencement of emergency operations;
 - Improved management review in the preparation of the financial statements;
 - Care in the management of commodity loans between programme categories;
 - Disclosure of waivers of indirect support costs;
 - Improved financial management and monitoring;
 - Consistency in the valuation and recording of contributions in kind;
 - Continued action to resolve unreconciled UNDP accounts;
 - Action to reduce the risk of fraud.

SCOPE AND APPROACH OF THE AUDIT

- *Summary of audit scope, approach and overall conclusions.*

Audit Scope

9. I have audited the accounts of the World Food Programme (WFP) for the financial period 1 January 2004 to 31 December 2005 in accordance with Chapter XIV of the Financial Regulations and the Additional Terms of Reference Governing External Audit appended thereto.

Audit Objectives

10. The main purpose of the audit was to enable me to form an opinion as to whether the expenditure recorded in the financial period had been incurred for the purposes approved by the Executive Board; whether income and expenditure were properly classified and recorded in accordance with the Financial Regulations; and whether the financial statements present fairly the financial position at 31 December 2005.

Audit Standards

11. My audit was conducted in accordance with the Common Auditing Standards of the Panel of External Auditors of the United Nations, the Specialized Agencies and the International Atomic Energy Agency. These standards require me to plan and carry out the audit so as to obtain reasonable assurance that the financial statements are free from material misstatement. The WFP's management are responsible for preparing the financial statements and I am responsible for expressing an opinion on them based on evidence obtained in my audit.

Audit Approach

12. In accordance with the Common Auditing Standards, my audit included a general review of the accounting systems and such tests of the accounting records and internal control procedures as I considered necessary in the circumstances. The audit procedures are designed primarily for the purpose of forming an opinion on WFP's financial statements. Consequently my work did not involve detailed review of all aspects of financial and budgetary systems and the results should not be regarded as a comprehensive statement on them. My audit included focussed work in which all areas of the financial statements were subject to direct substantive testing. A final examination was carried out to ensure that the financial statements accurately reflected WFP's accounting records and were fairly presented.
13. My audit was supported during the biennium by visits undertaken by my staff to all six of the WFP Regional Bureaux and 13 Country Offices, where they reviewed the operation of controls during the biennium and undertook substantive testing of transactions at each location. At the end of each of these audit visits, my staff provided a management letter to the Executive Director outlining their key findings. My staff also provided the Executive Director with management letters as a result of audit planning work; their review of Tsunami-related activities; and a preliminary briefing of the impact of international accounting standards for the Finance Division in Rome.

Audit Conclusion

14. My report includes a number of observations and recommendations intended to be of benefit to the Executive Board; and, in accordance with normal practice, my staff recorded additional findings in management letters to the Secretariat. None of these matters materially affected my audit opinion on WFP's financial statements for the biennium and, notwithstanding the observations in this report, my examination revealed no weaknesses or errors that I considered material to the accuracy,

completeness and validity of the financial statements as a whole and I have placed an unqualified audit opinion on the financial statements for 2004-2005.

DETAILED FINDINGS FOR 2004-2005

Audit findings on financial matters:

- *Governance and internal oversight*
- *Tsunami emergency operations*
- *Preparation of the financial statements*
- *Accounting and disclosure of project expenditure – commodity loans*
- *Indirect support costs*
- *Financial management controls*
- *Accounting for contributions-in-kind*
- *Transactions with UNDP*
- *Staff benefit funds*
- *Long term loan*
- *Fraud, ex-gratia payments, amounts written-off and contingent liabilities*

Governance and internal oversight

15. In May 2004, with the endorsement of the Executive Board, its Bureau and the Steering Group on Governance, the Executive Director commendably restructured the Audit Committee to include a majority of independent, external, financially experienced members². The Audit Committee established new terms of reference aimed at providing advice to the Executive Director and the Executive Board on the Programme's internal control environment; internal and external audit coverage and

² ED2004/003.

outputs; financial management; and accounting. My staff have been working with the Audit Committee to support and contribute to the Committee's oversight efforts and to ensure a productive partnership between the Audit Committee, External Audit, Internal Audit and the Secretariat.

16. During the biennium, the Audit Committee has actively scrutinised the organisation's risk management procedures; advised the Secretariat on proposed management initiatives including the hedging of foreign exchange; encouraged the development of a risk-based approach to the planning by Internal Audit; considered the outputs of both Internal and External Audit; and reviewed the biennial financial statements. The Committee's oversight has enhanced corporate governance by drawing on the member's wealth of experience in the management of business operations and audit.
17. In my report to the Executive Board on corporate governance³ in June 2004, I had noted the absence of any formal reporting of audit committee findings or deliberations to the Executive Board. In accordance with the Audit Committee's new terms of reference⁴, the first annual report from the Committee was presented as an information paper to the September 2005 Executive Board⁵. As a matter of good practice in governance, it is important that the Audit Committee should have an active relationship and dialogue with the governing body; and that the Executive Board should receive, and discuss, annual reports from the Audit Committee.
18. The independence of the Audit Committee, which offers an important source of expert advice to the Secretariat and to the Executive Board, is also a key element in good governance arrangements. I welcome, therefore, the Executive Director's intention to further extend the external membership of the Committee during the 2006-2007 biennium which, with continued senior management attendance at meetings, will further enhance WFP's corporate governance arrangements and ensure the greatest benefit from the Committee's oversight. The independence of the Audit Committee would be further enhanced by the Executive Board's formal acknowledgement of its role and mandate.
19. WFP's Oversight Services Division (OSD) comprises an Internal Audit function (OSDA) and an Investigations and Inspections function (OSDI), forming an essential element of effective corporate governance by providing management with ongoing assessments of the efficiency of resource utilisation, the operation of key management controls, and adherence to donor authorisations⁶.
20. During the biennium my staff and OSD liaised on audit coverage to avoid unnecessary duplication of field visits; exchange programmes of work and reports to management; and follow up recommendations from either party. This approach assisted the assessment of financial controls and audit risks when completing audit reviews. My

³ WFP/EB.A/2004/INF/8-C.

⁴ ED2005/5.

⁵ WFP/EB.2/2005/5-H/1.

⁶ WFP/EB.s/2003/5-A/1.

staff take account of the findings from OSD's work to inform their own activities and in evaluating the adequacy of WFP's internal control environment.

21. In late 2005, OSD completed a robust review of WFP's financial records prior to the closure of the biennial accounts and preparation of the financial statements. This work was highly useful to management in:
- Enabling the Secretariat to prepare a plan to address financial issues and accounting errors revealed by the review; and
 - Assisting the preparation of the 2004-2005 financial statements by informing corrections and adjustments to the financial records prior to external audit examination.
22. Because of the significant role of OSD, I had previously undertaken to review and confirm the adequacy of internal audit arrangements as part of my work for 2004-2005.
23. Throughout the biennium, my staff examined OSD reports, work plans and field-based audits; and in February 2006 reviewed the report of an external quality assessment carried out at OSD's request by the Institute of Internal Auditors (IIA). This assessment measured OSD against international standards for the professional practice of internal auditing, with the objective of:
- Evaluating the Division's effectiveness and efficiency; and
 - Identifying opportunities to enhance OSD's management of resources and work processes.
24. The IIA concluded that OSDA generally conforms to the professional internal audit standards but that there remained scope for improvements through 11 recommendations to OSDA and two recommendations to management. The wide-ranging recommendations covered, inter alia: the independence of internal audit staff; the need to implement risk-based assessments and increase audit coverage of technology risks; more detailed resource planning; earlier reporting; enhanced monitoring; and more consistent application of working standards and documentation. I welcome OSD's initiative to commission the Institute's independent professional assessment and I endorse the findings and recommendations, which I believe should enhance the efficiency and effectiveness of the OSDA.

Recommendation 1: To reinforce the independence of the Audit Committee and ensure a closer alignment of WFP's arrangements with best practice in governance, I recommend that the Executive Board formally acknowledge the role and mandate of the Audit Committee.

Recommendation 2: I recommend that OSDA finalise an implementation plan for the IIA recommendations, setting out priorities and time-lines against which progress can be monitored.

Emergency operations - Tsunami

25. The Tsunami disaster on 26 December 2004 triggered one of the most complex and wide-reaching emergency relief operations mounted by the World Food Programme. The operation had a budget in excess of US\$200 million aimed at providing in excess of 260 thousand tonnes of food aid to the affected areas. As part of their 2004-2005 audit, my staff visited WFP's emergency operations in Thailand, Indonesia and Sri Lanka, to:
- Observe operations in the field;
 - Review expenditure transactions and the way in which funds were used;
 - Examine stock, inventory, cash and bank procedures;
 - Consider management oversight arrangements; and
 - Form a view on the adequacy of control procedures applied by WFP.
26. My staff concluded that WFP's response to the Tsunami disaster was adequately managed. Operations were effected quickly and significant levels of food were organised and delivered promptly. The operation appeared to have been adequately co-ordinated at Headquarters, at the Thailand Regional Office and within affected areas, where WFP co-ordinated activities with key partners, various government departments and other humanitarian agencies as part of the global response to the disaster.
27. To retrospectively assess the effectiveness of internal controls in any emergency situation presents difficulties, particularly in the verification of the existence and effectiveness of those controls during the initial emergency phase, when the first priority is to save lives. Inevitably in such circumstances, issues such as internal control, segregation of duties, procurement procedures, adequate documentation and certification processes may have to be managed in the context of the need to expedite the humanitarian response in circumstances where lives are at risk.
28. My staff's review of the control environment for the Tsunami activities identified control weaknesses at various times throughout the operation. Controls were weakest at the initial phases in the affected field office locations although, as the operation evolved, internal controls were put in place or improved. My staff also found some internal control weaknesses at a country office level, where WFP were operating prior to the Tsunami occurring and where a more established and stable internal control framework might be expected.
29. Control weaknesses identified included lack of security and delayed compliance with Minimum Operating Security Standards in the early stages of WFP's response; late or poorly supported information monitoring, for example of beneficiary numbers; incomplete recording of food losses; incomplete inventory control; and poor quality record keeping.

30. Notwithstanding the extremely challenging circumstances of emergency operations, with which much of WFP's worldwide activity has to contend on a daily basis, any deficiencies in the internal control environment can give rise to an increased risk of inappropriate use of funds or resources, although my staff's audit examination identified no evidence of fraud or irregularity.
31. Where regional bureaux staff have oversight responsibilities but are also directly responsible for emergency operations, as occurred in the Thailand Bureau for the Tsunami emergency operation, the effectiveness and independence of the oversight function can be compromised. In these circumstances, an emergency administrative workforce could lessen the risk of inadequate or reduced oversight. At the time of finalizing this report, management were considering the establishment of an administrative task force which could be dispatched rapidly to emergency operations and help to secure the implementation of necessary procedures and control systems.

Recommendation 3: I recommend that the Secretariat take forward its plans for the establishment of a flexible administrative workforce for emergency-operations, which could ensure the establishment of adequate financial controls in a timely fashion for future emergency situations.

Preparation of the financial statements

32. In 2004-2005, my staff continued to work closely with the Secretariat to encourage clarification and simplification of the financial statements and Notes to the accounts. In continuing preparation for the Programme's welcome move towards improved financial reporting that will be in compliance with the more stringent requirements of international accounting standards, management have introduced a number of improvements in the transparency of disclosures and to give greater clarity in the Notes describing the financial results for the biennium. Note 3 to the accounts explains the changes in presentation and consequential adjustments which the Secretariat introduced, principally to achieve:

- Fuller disclosure of income and expenditure on Trust Funds and bank charges;
- More transparent disclosure of the movements in staff benefit funds; and
- Greater consistency in the reporting in Statement II of balances resulting from transactions of third party arrangements and the movement in reserves.

Note 3I explains the adjustments made to prior period figures to assist comparison of results with 2002-2003.

33. The extent of these presentational changes and the timeframe for preparation of the financial statements led to considerable modification to the financial statements that were initially presented for audit. This process was inevitably highly compressed against the deadline for the Executive Director's signature of the accounts and many changes were required at a very late stage. Finance staff worked extremely diligently to make necessary corrections and changes to the financial statements in draft. While the Secretariat continue to improve the quality and robustness of the information reported in the financial statements, there remains scope to formalise and improve the

quality of management review of the financial results, and to reduce the need for last minute adjustments to figures, schedules and disclosures. For example, prior period adjustments reported in Note 17A to the accounts reflect current biennium amendments rather than retrospective changes to the prior period's figures; and other adjustments reported in Note 7, Contributions Receivable, include \$26.3 million as a balancing figure at the time of signature of the financial statements.

Recommendation 4: As part of the accounts preparation planning, I recommend that the Secretariat establish improved and timely procedures to allow for review and reduction of any unexplained adjusting items in the figures reported in the financial statements, and to facilitate an effective quality review by management of the financial statements prior to submission for audit.

Accounting and disclosure of project expenditure – commodity loans

34. In my report on the 2002-2003 financial statements, I noted the incidence of inaccurate recording resulting from circumvention of the strong system controls in WINGS in order to deal with funding constraints or delays on projects. As a key financial control, WINGS does not allow expenditure to be posted against a project where there is insufficient funding. In 2004-2005, the Secretariat had addressed the need for country offices to maintain operations by allowing, in effect, temporary commodity loans between programme categories, so that expenditure on a project could be charged to a different active project with sufficient funds. Within this arrangement, commodity loans amounting to an estimated US\$55 million from emergency operations had been made to other programme categories as at end December 2005. In these circumstances, contributions of food aid by donors were applied to emergency operations other than those specified by the donors, with the intention that such loans would be repaid to the relevant operation.
35. Optimising the use of resources is consistent with the management objectives of the Strategic Plan 2006-2009⁷, to achieve excellence in implementing efficient and effective programmes to provide timely and appropriate assistance that supports combined efforts to reduce hunger, particularly in response to crisis needs. Nevertheless, there remains a risk that unforeseen shortfalls in commodity donations could restrict the prompt recovery of the loaned commodities when required by the programmes to which they had been originally allocated.

⁷ WFP/EB.2/2005/5-A/Rev.1

Recommendation 5: *I recommend that the Secretariat ensure that any commodity loans between programme categories for operational reasons should be made subject to:*

- *Realistic risk assessment of the likelihood of recovery;*
- *Confirmation on a case-by-case basis that the loans do not conflict with any original donor restrictions on their use; and*
- *Disclosure of the balance of such loans in the financial statements, so long as this information can be obtained cost-effectively.*

Indirect support costs

36. In February 2004 the Executive Board considered the recovery of indirect support costs from contributions and provided a waiver of indirect support costs for the 2002-2003 biennium in relation to the additional cargo preference costs that arise because a major donor requires transportation of food by its own country supplier of transportation. During 2004-2005, WFP enhanced its accounting arrangements and agreed with the major donor for the separation of the additional costs arising from cargo preference, which has enabled the recording of cargo preference as a third party agreement. The agreement excluded the levy of administration charges on the additional costs, since the extra administrative burden for cargo preference was deemed insignificant in comparison with the extent of administrative support for transportation and other services for which the costs are paid by the donor.

37. My staff's review of a sample of 30 contributions amounting to US\$388 million revealed that five waivers of support costs had been made under WFP financial rules. The waivers of indirect support costs amounted to US\$0.67 million, representing two per cent of the expected support costs totalling US\$27 million at the seven per cent rate approved by the Executive Board.

Recommendation 6: *In the interests of transparency and completeness of financial reporting, I recommend for the future that the Secretariat consider estimating and disclosing the extent of waiver of indirect support costs in the Notes to the financial statements.*

Financial management control

38. The establishment of stronger administrative processes and the enhancement of financial expertise in the field were key concepts in WFP's Biennial Management Plan for 2004-2005⁸. In my financial report to the 2002-2003 financial statements I drew attention to the very limited level of monitoring and oversight applied by Headquarters

⁸ WFP/EB.3/2003/5-A/1

to the respective Regional Bureaux after the responsibilities for financial monitoring and oversight were devolved from Rome.

39. In their field visits during 2004-2005, my staff confirmed the increased importance given to financial oversight through regional training of financial staff and the transfer of financially qualified and experienced staff from Headquarters to the regions.
40. My staff also confirmed the significant efforts made by the Secretariat to strengthen financial controls at Headquarters, in particular the preparation of monthly management accounts started in mid-2004, which enabled the Secretariat to consider resource utilisation and compare the collection rates of receivables and the payment of obligations to previous months and financial periods. Nevertheless, there remains scope for improvement, particularly in relation to the following:
- Timely and robust reconciliation processes, which include the prompt clearance of balancing items between cash in bank statements and the WINGS accounting system, are a fundamental management control over the propriety and validity of accounting records. At the end of the biennium, Internal Audit had identified worldwide balancing items in bank reconciliations to a gross value in excess of US\$452 million (US\$15 million net), of which US\$21 million had remained outstanding for more than 90 days and US\$29.8 million for more than a year. The Secretariat is taking action to clear these outstanding items during 2006.
 - Because of the way in which the WINGS system is currently set up, the analysis of cash and short-term investments (amounting to US\$1.13 billion reported in Statement II) provides an allocation of cash to programme and other fund categories, but is based on balancing entries for each fund category rather than amounts recorded against general ledger codes, which would more fully comply with generally accepted accounting standards.
 - Accounts receivable from vendors and staff amounted to US\$114.2 million as at 31 December 2005. An Internal Audit report of 8 March 2006 identified that, while considerable effort had been made in clearing long outstanding items, there were still significant balances in accounts receivable. (At the time of audit, some US\$23 million had been outstanding for more than a year.) Failure to collect longstanding receivables inevitably increases the risk of non-recovery and subsequent write-off.
 - Accounts payable and outstanding obligations totalled US\$885 million, arising in part from 59,000 purchase orders of which 43,852 had remained open for more than a year. With the aim of reducing duplication or invalid entries, the Secretariat has instigated a review of the validity of vendor listings, which had grown to 55,000 in number.
 - Inventory records of WFP's worldwide truck fleet valued at some \$23.8 million had not been kept up-to-date at headquarters, increasing the risk of undetected inventory loss and inaccurate records.
 - At present, the accounting system matches payments to creditor records by value rather than by using a unique transaction identifier, with the result that a number of payments may be recorded against the incorrect supplier. This requires subsequent manual review and correction;

- Adjustments in excess of US\$529 million have been made to contributions and are reflected in the financial statements. These adjustments represent approximately eight per cent of the income declared in 2004-2005, reported in Statement I at US\$6.3 billion. This high level of adjustments indicates that scope exists for improved income forecasting and estimation, to facilitate timely reallocation of available resources. For 2004-2005, the adjustments comprised:
 - US\$266 million write down of unspent contributions which had not been received by the time projects were financially closed (Notes 7 and 16 to the financial statements refer);
 - US\$176 million of reprogrammed and refunded balances of financially closed projects (Note 16); and
 - US\$87 million prior period adjustments which are reductions of contributions receivable recognised as income in prior periods (Note 17A).

Recommendation 7: I recommend that the Secretariat consider improving financial monitoring and control to:

- ***Complete the clearance of longstanding bank reconciliation items and ensure prompt clearance in future;***
- ***Ensure an adequate audit trail for cash and short term investments from the general ledger to the analysis by fund category at Statement II;***
- ***Review receivables and payables to write off uncollectible amounts and delete invalid liabilities in a timely fashion;***
- ***Grant new advances only when earlier advances are fully liquidated;***
- ***Ensure complete and up-to-date recording of inventory in the central database;***
- ***Consider the benefits of accounting system changes to eliminate errors which require inefficient manual review and correction; and***
- ***Review the underlying reasons for write downs and ensure the prompt redirection of unspent cash balances of financially closed projects with the appropriate donor approval.***

Accounting for contributions of services in kind

41. WFP's Strategic Plan for 2006-2009⁹ confirmed an objective to broaden WFP's donor base to increase programme funding. To meet this objective, during 2004-2005 the Secretariat encouraged donations of services in kind, amounting to US\$70 million (Statement 1). The Strategic Plan also identified weakness in resource mobilisation

⁹ WFP/EB.2/2005/5-A/Rev.1

through lack of public awareness of WFP in some donor countries, in response to which one service in kind supported an advertising campaign initially valued at US\$46 million over the biennium.

42. United Nations Accounting Standards (UNSAS) encourage the reporting of significant voluntary contributions in kind, which can be used in the normal course of an organisation's programme activity, and for which a fair valuation can be reasonably estimated. The basis of the fair valuation of the contributions should be disclosed with the donor's valuation if appropriate.
43. The valuation of such contributions in terms of their use in the normal course of programme activity may present difficulties and require different valuation methodology. Personnel services are valued at standard staff cost rates. Other services in kind are valued at world market prices where applicable, although contributions of local services are valued according to the relevant contractual agreements. Furthermore, at present WFP does not disclose the benefits of services in kind consistently, treating the host Government contribution towards the rent and maintenance of the Headquarters premises (valued in excess of US\$19 million in 2004-2005) as a third party agreement excluded from valuation in the financial statements.
44. My staff's examination of a contribution of advertising services valued at \$57 million revealed that the relevant Country Office had confirmed that the benefits to WFP would be gained over a number of years. To ensure compliance with UNSAS, and in the absence of independently-corroborated valuations of this and other contributions, the Secretariat have disclosed the contribution in Note 19 to the financial statements but without recognising a valuation for the purposes of the Statement of Income and Expenditures, Statement I.
45. I consider that proper assessment of the Secretariat's performance in obtaining contributions in kind against the objectives of the strategic plans requires a robust evaluation of the costs and benefits to WFP of the services in kind. Without this, there is a risk that a valuation for financial purposes could be understated to reduce associated indirect support charges; or inflated to achieve income targets or for political advantage.

Recommendation 8: I recommend that the Secretariat takes steps to establish improved arrangements for the effective quality review of the financial statements for the consistent disclosure and fair WFP valuation of services-in-kind contributions in compliance with the appropriate accounting standards.

Transactions with the United Nations Development Programme

46. Note 6 to the financial statements draws attention to the efforts made by WFP to reconcile and clear more than 64,500 transactions held in a general ledger account relating to the United Nations Development Programme (UNDP), more than 18,000 of which date back to 2004. In this account, WFP records payroll costs, expenditure and other service charges in relation to which UNDP makes payments on behalf of the Programme. WFP advanced US\$8 million to UNDP each month in 2004-2005 to cover the expected full costs of the services provided. UNDP records of worldwide payments should reconcile to WFP's records, enabling the cancellation of items from the account. Difficulties arising from the implementation of a new computer system at UNDP resulted in the transactions not being matched in a timely manner, leaving a net balance of US\$29.6 million (US\$95 million gross) unreconciled in the account.
47. From their review of WFP's records, my staff were content that the balance shown in the financial statements as due to WFP from UNDP is fairly stated, although WFP cannot finally confirm this until all the outstanding items have been reconciled.

Recommendation 9: *I recommend that the Secretariat maintains its efforts to clear outstanding items from the UNDP account 60015 to provide assurance that records of expenditure are complete and payments valid.*

Staff benefit funds

48. Staff benefit funds, comprising an After-Service Medical Coverage Plan, a Separation Payments Scheme and the Compensation Plan Reserve Fund, are disclosed in Note 12A to the financial statements. The total value of fund assets amounting to \$79.5 million compares unfavourably to the estimated future liabilities of the fund which total \$111.2 million (Note 12A4), resulting in an anticipated deficit in excess of \$31.6 million. My staff confirmed that the actuarial deficit had been arrived at by an established professional actuarial company; and that the explanation of the deficit and the assumptions of the actuarial report appeared to be reasonable. The Secretariat proposes to implement the recommendations of the actuarial report and address the deficit through an increased annual charge of US\$1.6 million to cover liabilities related to previous staff service and US\$8.5 million to cover those liabilities accumulating from current service.

Long term loan

49. In December 2000, WFP reached an agreement with a major donor to facilitate the provision of food assistance to two country projects (Note 19G to the financial statements refers). Under the arrangement, the donor contributed income of US\$106 million to cover the cost of commodities which WFP then purchased from a government agency in the donor country. Since the repayment of the cost of food was to be made over a thirty year period, WFP invested a capital sum from the cash donation sufficient to repay the loan at the end of the thirty year term. In a decision in

2002¹⁰ the Executive Board had approved the use of proceeds from this investment to fund expenditure plans proposed by the Executive Director and to use the proceeds, including US\$39.9 million which was not required to be invested long-term, to repay the commodity costs over the thirty year agreement.

50. My staff confirmed that the resources had been used in accordance with contractual arrangements with the donor, the Executive Board Decision and as disclosed in Notes 19F and 19G to the financial statements. However, for any similar arrangements in the future, to accord with generally accepted accounting standards WFP should account for the proceeds from investment interest only at the time such proceeds are earned, rather than in anticipation of the earnings over future accounting periods.

Fraud, ex-gratia payments, amounts written off and contingent liabilities

51. The Secretariat informed my staff that during the biennium WFP had identified 35 cases of fraud and presumptive fraud amounting to an estimated value in excess of US\$8.8 million, of which US\$6 million involved a single case in South Africa. US\$4.7 million was written off during the period as irrecoverable losses under Financial Regulation 12.4. Under the authority of Financial Regulation 12.3, the Executive Director authorized ex-gratia payments for 2004-2005 totalling US\$582,068, mainly in relation to bomb victims in Baghdad and an early retirement payment. Management informed my staff of contingent liabilities amounting to US\$6 million, as reported in the Notes to the financial statements.
52. The most significant case of fraud or presumed fraud occurred in the Regional Bureau in Johannesburg, which the Secretariat had established in October 2002 in the midst of a rapid expansion of regional emergency operations aimed at addressing food crises throughout Southern Africa. Following an audit visit in May 2003, my staff drew attention to financial control weaknesses, in particular a lack of reconciliation of bank records to those in the WINGS accounting system; inadequacies in basic management control over the propriety of accounting records; a high level of mispostings and late postings of transactions; longstanding supplier advances; inadequate training on the new WINGS accounting system; and the need for systematic management review of expenditure against budget. On completion of a further audit visit to Johannesburg in November 2004, my staff noted some improvements in bank reconciliations but expressed concern to management over the effectiveness of financial oversight, retroactive posting of transactions, and control and security risks from inadequate controls over access to WINGS. In February 2005 the Secretariat introduced systems controls intended to prevent retroactive recording of accounting records.
53. According to reports provided by WFP's internal investigation team, this case involving some US\$6 million occurred through staff colluding and taking advantage of weaknesses in financial management control, notably:
- The delegation of responsibility by Headquarters without additional management oversight;

¹⁰ WFP/EB.2/2002/14

- A failure to monitor and properly manage security access locally;
- Unacceptable sharing of passwords and other access controls between staff using electronic fund transfers to pay suppliers; and
- Inadequate security and custody of personal identification numbers.

54. In another case, an arbitration settlement between WFP and a South African supplier resulted in an unforeseen liability of some US\$4 million, for which negotiations over the interest and foreign exchange charges have been included by the Secretariat in disclosures of contingent liabilities in the Notes to the financial statements.

Recommendation 10: I recommend that the Secretariat:

- *Confirm the adequacy of internal controls at regional level;*
- *Consider the need to improve the extent and quality of management oversight by Headquarters to ensure that controls are applied in practice;*
- *Consider whether there is a need to respond more effectively to audit findings and recommendations.*

FOLLOW-UP TO THE 2002-03 EXTERNAL AUDITOR'S REPORT

55. As a matter of good practice my staff review the progress made by the Secretariat in responding to audit recommendations presented to the Executive Board for the previous financial period. In addition this year, the Secretariat have reported to each Executive Board session on progress against management report recommendations. I welcome this comprehensive regular reporting, which provides a focus for accountability and good governance.

56. My comments therefore address the Secretariat's response to my previous recommendations dating from 2002-2003; including those that my staff consider have not been fully addressed, even where the final progress report in the financial period (to the November 2005 Board ¹¹) had classified management action as being complete. Audit recommendations for 2002-2003 related to my biennial report on the 2002-2003 financial statements ¹² and my management reports on WFP's Human Resources Strategy, Air Operations ¹³, Vulnerability Analysis and Mapping ¹⁴ and Corporate

¹¹ WFP/E.B.2/2005/5-F/1.

¹² WFP/EB.A/2004/6-B/1/3.

¹³ WFP/EB.A/2004/INF/8-A.

¹⁴ WFP/EB.A/2004/INF/8-B.

Governance¹⁵. In each area I can confirm that the Secretariat has made significant progress in implementing the recommendations.

57. **Concerning my report on the audit of the accounts for 2002-2003**, presented to the Board in June 2004, during field visits to nineteen countries during 2004-2005 my staff generally found evidence of improved financial awareness and financial training of staff. In their view, however, the acceptance and implementation of the accountability framework at regional bureau and country office level was not applied wholly consistently, with some locations contacting headquarters on issues that could be resolved at the regional level. My staff will continue to review the accountability framework during field visits in 2006-2007.
58. Since the upgrade to WFP's accounting system, WINGS, has still to be implemented, my staff consider that the inadequacies in WINGS' reporting arrangements are still outstanding and they raised these concerns in my report on WINGS to the June 2005 meeting of the Executive Board.
59. **On Human Resources**, the Secretariat response to my first recommendation refers to the reporting of staff expenditure after the implementation of the WINGS upgrade. At present, my staff regard this recommendation as ongoing rather than completed until the upgrade has been successfully implemented and tested.
60. Regarding my recommendations on **Air Operations**, I can confirm that management action generally has been as reported, but my staff will continue to review air operations in field visits where the impact of the management reported action can be most effectively examined. They will also consider reports from the Office of Internal Oversight.
61. Considering the recommendations in my report on **Vulnerability Analysis and Mapping**, the Secretariat referred to the introduction of a Directive in September 2005 and an analytical checklist in 2006. My staff believe any assessment of the effectiveness of these recent actions requires review of beneficiary numbers, location and results-based performance during and after project activity, in particular those related to emergencies. My staff will therefore continue to examine the management of vulnerability assessment and the performance indicators implemented by the Secretariat.
62. My staff's review of progress on the recommendations from my **Corporate Governance** report confirmed the position outlined in the information paper provided to the November 2005 Executive Board¹⁶.

¹⁵ WFP/EB.A/2004/INF/8-C.

¹⁶ WFP/EB.2/2005/5-H/1.

ACKNOWLEDGEMENT

63. I wish to record my appreciation for the co-operation and assistance provided by the Executive Director and the staff of the WFP during my audit.

A handwritten signature in black ink that reads "John Bourn". The signature is written in a cursive style with a large initial 'J'.

Sir John Bourn
Comptroller and Auditor General, United Kingdom
External Auditor

ANNEX I**WFP BUREAUX AND COUNTRY OFFICES VISITED BY THE
EXTERNAL AUDITOR IN THE 2004-2005 BIENNIUM**

Regional Bureau	Bureau location	Countries visited
Asia	Bangkok, Thailand	DPR Korea Indonesia Sri Lanka
Mediterranean, Middle East and Central Asia	Cairo, Egypt	Tajikistan Afghanistan Pakistan Dubai
West Africa	Dakar, Senegal	
Southern Africa	Johannesburg, South Africa	Zambia Mozambique
East and Central Africa	Kampala, Uganda	Democratic Republic of the Congo Ethiopia Sudan
Latin America and the Caribbean	Panama City, Panama	Nicaragua