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FINANCE COMMITTEE

| **Hundred and Sixty-first Session** |
| **Rome, 16 - 20 May 2016** |
| **FAO Internal Control Framework** |

EXECUTIVE SUMMARY

➤ FAO has strengthened accountability structures over the delivery of the Programme of Work and Budget by reinforcing delivery of Strategic Programmes, creating performance standards to assess the achievements and monitor progress of programme teams, and put in place an Operational Monitoring Dashboard to provide quantitative and qualitative information to enable managers to assess progress against the performance standards.

➤ The FAO Internal Control Framework was formally approved in April 2016.

➤ Steps are being taken over the next 18 months to put in place the process and evidence to support the production of a Statement on Internal Control, to be attached to the financial statements at the end of 2017.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

➤ The Finance Committee is provided for information and discussion progress on applying accountability and the FAO Internal Control Framework.

Draft Advice

➤ **The Finance Committee took note of the measures to improve accountability, the adoption of the FAO Internal Control Framework and the steps to introduce a Statement of Internal Control.**

Background

1.   This is the fourth progress report to the Committee on FAO's Accountability Policy and Internal Control Framework. The first report in November 2013[1] outlined the conceptual approach the Secretariat was taking to embed accountability and internal control in FAO's working practices, with risk management providing the link. The second progress report in May 2014[2] explained that the main priority for accountability and internal control had been to support the implementation of the FAO Strategic Framework through the Medium Term Plan and the Programme of Work and Budget, and to embed risk management in FAO's work. The most recent progress report, in March 2015[3], presented FAO's Accountability Policy to the Committee. The Committee looked forward to receiving information on the implementation of the Accountability Policy and the Internal Control Framework at its session in May 2016.[4]

2.   As the Committee will recall, the Secretariat's work on accountability and internal control is undertaken within the overall policy objective of improving financial and administrative integrity in FAO and the achievement of programmatic results, also contributing to the consolidation of transformational change. The work comprises establishing and embedding in FAO's ways of working risk management, accountability and internal control.

3.   Policies relating to risk management and accountability are already in place and being implemented. This progress report illustrates the work being done in FAO to apply the concepts of accountability, and provides the FAO Internal Control Framework and the next steps for its implementation.

Applying the Concepts of Accountability

4.   Since FAO introduced the Accountability Policy, the principles of accountability have informed and been applied in the development of policies and tools across FAO. This is most clearly demonstrated in the measures taken to adjust and implement the Programme of Work and Budget (PWB) for 2016-17.

5.   Firstly, the management structure overseeing the delivery of the Strategic Objectives was reinforced. Full-time Strategic Programme Leaders replaced the part-time Strategic Objective Coordinators, and were given additional support in the form of a small dedicated management team. To increase coordination and develop mutual accountability for results, the Strategic Programme Leaders were placed under a single line of command through the Assistant Director-General (Technical Cooperation and Programme Management) to senior management. At operational level, a new role was created, of Delivery Manager, to manage the packages of work (delivery mechanisms) needed to achieve the results set out in the PWB.

6.   Secondly, FAO has created performance standards to provide a reference point for assessing the achievements and monitor progress of teams within these new roles, responsibilities and authorities. The contribution of each unit, whether a technical division or a decentralized office, to a delivery mechanism takes place within a Service Level Agreement, negotiated with Strategic Programme Leaders, and containing specified milestones, deliverables and budgets for the contribution of those units to results.

7.   Thirdly, an Operational Monitoring Dashboard has been released to provide quantitative and qualitative management information to enable managers to assess progress against the performance standards. The accountability loop is closed with quarterly meetings between divisions/regional offices

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[1] FC 151/20
[2] FC 154/17
[3] FC 157/15
[4] CL 151/3 paragraphs 32-33

and Strategic Programme Leaders to discuss progress against the standards, identify reasons for variances and take corrective action.

FAO's Internal Control Framework

8.   The FAO Internal Control Framework, formally approved in April 2016, is appended to this document. The Framework establishes accountability for the operation of the internal control system in FAO, by specifying policy objectives and benefits; the components of internal control, with the policies, procedures, tools and responsible units that support the components; and the respective responsibilities of managers and staff for the development, implementation, monitoring and improvement of the policies and tools.

9.   FAO's Internal Control Framework is based on the COSO model of internal control, as set out in the attached annex. The control techniques in the COSO model are being applied already, and are producing dividends in terms of improved performance. For example, in the area of extra-budgetary funds, analysis at the end of 2014 identified that some project managers did not fully respond to specific donor requirements; and too many projects were in need of management intervention, because of slow rate of spend, over-expenditure, overdue closure reports, or outstanding actions to administratively close a project.

10.   In response, FAO improved controls in the areas of supervision, systems design and knowledge and capacity. FAO first provided Regional Offices with data on the extent to which FAO Representations were observing corporate standards, highlighting those projects requiring urgent corrective action. This allowed Regional Offices to hold FAO Representatives accountable for compliance with standards, and Headquarters to hold the Regional Offices accountable for the effectiveness of their follow-up. Secondly, training and specialized support was provided to project budget holders, particularly those with complex operational requirements. By the end of 2015, these measures had proved successful; the number of projects requiring urgent corrective action had fallen by more than a third.

Next Steps

11.   The FAO Council, in its 153rd session in December 2015[5], endorsed observations in the Report of the 160th session of Finance Committee[6] and stressed the importance of strengthening the internal control framework at headquarters and decentralized offices, and the preparation of a Statement of Internal Control to be appended to the annual financial statements.

12.   Over the next 18 months, the Secretariat will take the following steps:

    a.   Introduce internal control self-assessment, to reinforce awareness of and compliance with key controls, to encourage managers and supervisors to agree priorities on where controls need to be strengthened and training provided.

    b.   This will provide the basis for preparing a Letter of Representation from senior managers to the Director-General on the controls over the operations they are accountable for; and a Statement on Internal Control to be attached to the Financial Statements.

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[5] CL 153/REP, paragraph 13i
[6] CL 153/7 paragraphs 8e and 27b

FAO Internal Control Framework

Introduction

1. FAO continually strives to improve the achievement of expected results, the use and stewardship of resources, and the quality of information provided to the Governing Bodies and other stakeholders. Improvement in these areas requires, as recognized by FAO management and its Governing Bodies, that compliance and control mechanisms are integrated into a coherent and comprehensive internal control framework.

2. The FAO Internal Control Framework (ICF), presented in this document, links existing corporate policies and compliance monitoring tools to the roles, responsibilities and accountabilities of managers and staff. In doing so, it creates a reference point for continued improvement, assessment and external reporting.

3. The purpose of this policy framework is to set out the main components of FAO's internal control system in response to risks to the Organization's objectives. The ICF, along with the FAO Accountability Policy and Policy on Risk Management, are integrated and mutually supportive systems that ensure the Organization achieves is objectives.

4. The ICF comprises a policy statement, definition and scope, application of internal control principles, roles and responsibilities, and internal governance. These provide the basis for providing assurance on internal control at FAO.

A. Policy Statement

5. The FAO Internal Control Framework covers all aspects of FAO's activity – whether financial, operational, compliance or environmental. Managers and staff throughout FAO are required to apply the ICF to develop, implement, monitor and adjust strategies, policies, processes and plans with the following benefits to the Organization and its Members:

    a) Smarter, leaner controls that better respond to the operational and other risks staff face in achieving FAO's objectives;
    b) Maintaining and improving the reliability, appropriateness and timeliness of financial and non-financial information;
    c) Improving the observance of legal, statutory or regulatory obligations; FAO's ethical standards; and of its internal rules;
    d) Reducing losses and waste of assets and resources, whether through misdirected effort, avoidable errors, mismanagement, abuse or fraud; and
    e) Sustaining and increasing the confidence among Member States and other stakeholders in the reliability, resilience and efficiency of FAO's management systems.

B. Definition and scope

6. FAO defines internal control as "the actions taken by FAO management to manage risk and increase the likelihood that established goals will be achieved"[1]. The FAO Internal Control

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[1] This is the definition of Institute of Internal Audit, which is the simplest and most direct. Earlier FAO definitions, based on COSO, defined internal control as "a process designed to provide reasonable assurance to FAO management regarding the achievement of objectives related to … five critical areas of performance – effectiveness, efficiency and economy, compliance, reporting and protection."

Framework, together with its policies on risk management and accountability, contains the policies, culture, organization, behaviours, processes, systems and other elements that taken together:

  a) facilitate effective and efficient operations by assessing current and emerging risks, responding appropriately to risks and significant control failures and safeguarding assets;
  b) reduce the likelihood and impact of poor judgment in decision-making; excessive risk-taking; human error; or the deliberate circumvention of control processes;
  c) help ensure quality internal and external reporting; and
  d) help ensure compliance with applicable laws and regulations, and also with internal policies.

C. Application of the five components and eighteen principles of Internal Control at FAO

7.   The FAO Internal Control Framework is based on the COSO model of internal control.[2] It sets out five inter-related components of internal control (risk assessment, internal environment, control activities, information and communication and monitoring) and eighteen principles that are required in order to have an integrated and effective internal control system to meet corporate objectives. The five components and supporting principles are set out below. The application of the principles of internal control, including lead unit, applicability to managers and staff, and supporting policies and tools, are elaborated in the Annex.

8.   Risk Assessment involves a dynamic and iterative process for identifying and managing the risks, including the risk of fraud, to the achievement of objectives. A precondition to the assessment of risks is the identification of objectives, aligned with and supporting FAO's strategic direction and linked together at various organizational levels.

9.   Internal Environment is the set of standards, processes and structures that provide the basis for controlling and directing FAO. It is influenced by objectives and risk and has a pervasive impact on the overall operation of control systems. It comprises the mechanisms that enforce integrity and ethical values; the example set by managers; the means by which Senior Management oversee the performance of control activities (structures, reporting lines, assignment and delegations of responsibility and authority); by which competent personnel are recruited, developed and retained; and by which individuals are held accountable.

10.   Control Activities are the actions carried out through policies and procedures to ensure that management directives on the management of risk are carried out. They affect manual and automated processes, and comprise, where appropriate, controls such as segregation of duties, authorizations, approvals, verifications, reconciliations and reviews.

11.   Information and Communication. Management obtains information from internal and external sources to be able to assess how well the different elements of its control system are performing in supporting the achievement of objectives. Information needs to be communicated internally, so that personnel are aware of the control priorities of management, and management and colleagues receive the information they need. External communication facilitates the inbound communication of external data, and the outward communication of information to meet the needs of third parties.

12.   Monitoring. Management monitors the operation of internal control through on-going and separate evaluations to confirm that required controls are present, functioning and having the required contribution to managing the risks to the achievement of objectives.

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[2] Internal Control - Integrated Framework; The Committee of Sponsoring Organizations of the Treadway Commission (COSO); 2013 - modified by Guidance on Monitoring Systems; The Committee of Sponsoring Organizations of the Treadway Commission; 2009.

D. Roles and responsibilities for internal control

13.   The **Conference** is FAO's sovereign Governing Body, comprising all Member States and Associate Members. It sets FAO's policy, approves its budget and reviews corporate performance. Through these responsibilities, and supported by FAO **Council** and the **Finance Committee**, it has a particular role in defining expectations about integrity and ethics, transparency and accountability for fulfilling responsibilities for internal control.

14.   All staff are responsible for, and have a role in, internal control; but the nature of that responsibility varies by level, as set out below.

15.   Under the Basic Texts[3], ultimate responsibility for establishing and maintaining the internal control framework rests with the **Director-General**. In discharging this responsibility, he is accountable to the Governing Bodies, and is supported by Deputy and Assistant Directors-General, internal governance mechanisms, other senior managers and employees.

16.   Senior managers of programmes (**Strategic Programme Leaders**), of decentralized offices (**Regional Representatives**), of headquarters departments (**Assistant Directors-General**), and of headquarters' Apex offices (**Directors**) are accountable to the Director-General, through Deputy Directors-General as appropriate, for

   a) Reinforcing, through their leadership and direction of management within their area of command, the values, standards, expectations and accountability for internal control;
   b) Implementing their specific responsibilities for internal control policies and procedures established through delegations or other instructions from the Director-General;
   c) Confirming that managers throughout their area of command, including for Regional Representatives the FAORs, observe internal control policies and procedures, and ensuring that significant control weaknesses are resolved;
   d) Overseeing the management of risk in all units within their area of command, including the management of risks and significant control weaknesses escalated to their attention; and
   e) Communicating to the Director-General or their supervisor (as appropriate) significant control weaknesses.

17.   Managers and budget holders of other offices (**Directors, Chiefs, Sub-regional Representatives, FAO Representatives**) are accountable for:

   a) Reinforcing, through their leadership and direction of managers and other staff reporting to them, the values, principles, standards, expectations and accountability for internal control;
   b) Implementing internal control policies and procedures in their unit;
   c) Identifying and resolving significant control weaknesses and risks; and
   d) Reporting to their direct supervisor significant control weaknesses and other risks that could prevent the achievement of objectives or otherwise cause significant reputational or financial harm.

18.   The **Deputy Director-General (Operations)** has functional responsibility for the system of internal control. The DDG (Operations) is accountable for:

   a) Ensuring development and updating of tools, guidance and standards as required to support managers and staff apply the internal control framework;
   b) Developing, maintaining and updating the corporate monitoring and reporting tools for risk and internal control;

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[3] Rule XXXVIII 2 (a); Regulation X

c) Providing technical advice and support to managers, particularly policy owners, on matters related to internal control.

19. **Policy owners of business processes** (e.g. heads of Business Units) implement the internal control framework through policies and procedures. They are accountable for:

a) Developing in consultation with users and other internal stakeholders policies, procedures and tools that address at least cost the priority risks faced by front line managers;
b) Defining and enforcing lines of accountability and reporting;
c) Monitoring and assessing the performance of policies and procedures to confirm that the anticipated benefits are being delivered, and seizing opportunities to improve efficiency;
d) Anticipating and responding to changes in the profile of the risks within their policy area faced by front line managers, for example from the external environment or from an evolution in FAO's Business Model; and
e) Sharing and evaluating with other Policy Owners and the internal governance instances as appropriate issues and trends that transcend the boundaries of organizational units and functions.

20. **Other managers and staff** are accountable for operating internal controls as prescribed in FAO rules, regulations, manuals, policies, procedures and other instructions. They look for opportunities to improve the effectiveness and efficiency of controls, and respond promptly to any gaps or weaknesses in controls, either by remedying it themselves or reporting it upwards. They report upwards any control deficiency, non-compliance, risk or other operational problem that threatens the achievement of objectives.

21. **The Ethics Officer and Ombudsman** promotes compliance with the Organization's rules, policies and procedures, and contributes to fostering a culture of ethical behaviour, transparency and accountability. S/he manages the Organization's financial disclosure and mediation programmes.

22. **The Office of the Legal Counsel** provides legal advice, services and support to the Director-General and the Governing Bodies, including during the development of policies, to ensure that FAO activities are carried out according to its Constitution, rules and regulations. It also provides advice on the wider legal interests of Organization, on contractual and other transactions, policy development and dispute resolution.

23. **The Director, Office of Strategy, Planning and Resources Management** manages FAO's policies on **accountability** and **risk management**. In this responsibility, the Director OSP works with other Senior Managers to:

a) establish a framework of responsibilities and mechanisms for performance standards, targets and reporting;
b) establish a risk management process and tools to help managers across the Organization identify, prioritise, mitigate and report on risk; and
c) Identify and report to the internal governance instances and the Director-General on significant risks to the achievement of the Organization's objectives.

24. The **Office of the Inspector-General**, the **Audit Committee**, the **Office of Evaluation** and the **External Auditor** support the implementation of these accountabilities in their reporting to the Director-General and assurance to the governing bodies on FAO's programmatic and operational performance.

a) The Office of the Inspector-General reports to the Director-General on FAO's internal controls, risk management, financial management and use of assets, and allegations of misconduct, including fraud.

b) The Audit Committee advises the Director-General on the work of the Office of the Inspector-General and on strategic matters related to FAO's system of internal control, risk management and governance.

c) The Office of Evaluation assesses the extent of achievements of projects, programmes, strategies, and policies by comparing actual and expected accomplishments, and assessing the results chain, processes, contextual factors and causality.

E. Internal Governance

25.   FAO's **Internal Governance** operates through the established Senior Management Meeting (SMM), the Corporate Programmes Monitoring Board (CPMB), and the Executive Management Monitoring Team (EMMT), each chaired by the Director-General.

a) The SMM provides guidance on policy, rules and procedures and reviews compliance, performance and effectiveness.

b) The CPMB provides strategic direction, coordination, oversight and continuous review of programme delivery, with a particular emphasis on Strategic Programmes. It acts as the forum for dialogue and problem resolution among Strategic Programme Leaders, Regional Representatives, and heads of technical departments and business units.

c) The EMMT undertakes follow up to, and monitoring of implementation of important corporate decisions, initiatives and activities. It instructs managers on necessary adjustments and resolution of problems, and complements and supports the work of other internal governance mechanisms such as the CPMB and the SMM.

26.   An **Internal Control Steering Committee** ensures effective implementation of the internal control framework. The Committee is chaired by the Deputy Director-General (Operations) and comprises the ADG/Technical Cooperation and Programme Management, the ADG/Corporate Services, and the Director, Office of Strategy, Planning and Resources Management.

E. Providing Assurance on Internal Control at FAO

27.   The following mechanisms for assessing the overall effectiveness of internal control will be put in place:

a) **Managers Self-Assessment** process. All managers with delegated authorities will complete a self-assessment checklist and ensure it is kept current. The self-assessment checklist will be used to inform the Annual Letter of Representation.

b) **Annual Letter of Representation**. The Deputy and Assistant Directors-General provide assurance to the Director-General on the functioning of internal controls within their management responsibilities.

c) **A Letter of Assurance** provided by the External Auditor, and an Annual Report by the Inspector General.

d) **Annual Statement of Internal Control**. On the basis of the above noted mechanisms, the Director-General appends a statement on the effectiveness of internal controls to the annual financial statements.

Annex: Application of internal control at FAO: Accountabilities, supporting policies and tools

Principle	--------------- Accountabilities ---------------		Supporting policies and tools
	Lead unit	Applicability to managers and staff	
INTERNAL ENVIROMENT			
1. **Integrity and ethical values**. Integrity and ethical behaviour is upheld through standards, processes and the example set by managers.	ODG, Ethics Officer	Managers follow FAO standards for integrity and ethical behaviour, and encourage and promote its adoption by staff. Staff follow FAO standards for integrity and ethical behaviour in carrying out their duties.	Standards of Conduct for the International Civil Service (MS 304); Staff Regulations (MS301); Appointment of the Ombudsman and Ethics Officer (DGB 2014/19) Ethics Committee (DGB 2012/07) FAO Values specified and included in PEMS assessments Financial Disclosure Programme (AC 2012/15) Policy on the prevention of harassment (AC 2007/05) Protection Against Sexual Exploitation and Sexual Abuse (AC2013/07) Procedures for Handling Gifts (AC 2012/14)
2. **Board oversight**. A board structure, independent of management, exercises oversight over the development and performance of internal control.	Governing Bodies	Managers and staff communicate transparently with the Governing Bodies.	FAO Basic Texts, including the Regulations and Financial Rules Resolutions and recommendations of the Governing Bodies Accountability Policy
3. **Structure, authorities and responsibilities.** Reporting lines are established, with delegated authorities, and defined roles and responsibilities.	ODG	Managers apply this principle throughout the entities and individuals under their command.	Accountability Policy; FAO Handbook Strategic and operational plans
4. **Skilled staff.** Individuals with the competencies needed to achieve objectives are recruited, developed and retained.	OHR	Managers and staff apply the policies and procedures developed by OHR, including monitoring, enforcing compliance and taking corrective action.	HR strategy FAO Handbook (HR policies and procedures) PEMS HR Training website (you@fao)

| Principle | Accountabilities | | Supporting policies and tools |
	Lead unit	Applicability to managers and staff	
5. **Accountability**. Individuals are held to account for their internal control responsibilities.	ODG, ADGs, Regional Representatives, SPLs, Business Unit Supervisors	Managers put in place internal accountability processes for functions assigned to staff in their units. Managers and staff comply with the internal control framework and take corrective measures.	Accountability Policy; FAO Handbook PEMS
6. **Strategic Direction.** Priorities of the Organization are established.	Director-General (through OSP) and governing bodies	Managers and staff apply priorities in designing and implementing programmes and projects.	Basic Texts II.F, Strategic Framework and Medium Term Plan
RISK ASSESSMENT			
7. **Clear objectives**. Objectives are defined with sufficient clarity to allow the identification of risks relating to objectives.	OSP, with ADGs, Regional Representatives, SPLs, Business Unit Supervisors	Managers apply this principle throughout the entities under their command.	Strategic and operational plans Accountability Policy
Manage risks through: 8. Risk identification 9. Risk assessment 10. Risk mitigation.	OSP	Managers and staff apply this principle in preparing plans, projects, strategies and business development proposals (eg Capex).	Risk Management Policy Policy on Fraud and Improper Use of the Organization's Resources
CONTROL ACTIVITIES			
11. **Control activities**. Control activities are established to address risks to the achievement of objectives.	SPLs, ADGs, Regional Representatives and Business Unit Supervisors	Managers and staff apply this principle in preparing plans, projects, strategies and business development proposals (eg Capex).	FAO Financial Rules; FAO Handbook;
12. **Information technology controls**. General controls over the use of technology are selected and developed, to support the achievement of objectives.	CIO	Managers and staff observe the policies, procedures and standards established by the Chief Information Technology Officer.	CIO Strategy IT policies, procedures and standards IT systems controls

| Principle | --------------- Accountabilities --------------- | | Supporting policies and tools |
	Lead unit	Applicability to managers and staff	
13. **Policies and procedures.** Control activities are deployed through policies that establish what is expected and procedures that put those policies into action.	CPMB, with SPLs, ADGs, Regional Representatives and Business Unit Supervisors	SPTs, ADGs, Regional Representatives and Business Unit Supervisors are accountable for ensuring that the ICF is applied in developing processes and activities. Managers and staff apply this principle in carrying out their work, including monitoring, enforcing compliance and taking corrective action.	Delegation of authority Terms of reference Official communications (Administrative Circulars, DG Bulletins, etc.) FAO Handbook
INFORMATION AND COMMUNICATION			
14. **Information.** Relevant, quality information is obtained or generated and used.	CPMB, with SPLs, ADGs, Regional Representatives and Business Unit Supervisors	Managers apply this principle across the entities and individuals under their command, and in the development of policies and procedures. All staff share and promote the use of relevant, quality information.	Resolutions and recommendations of the Governing Bodies Confidentiality Policy FAO In-Touch; web portal, social media, press releases, etc. Strategic and operational plans Corporate Dashboard; budget reports Mid Term Review/End of Biennium Assessment/Programme Implementation Report Annual Financial statements Audit and Evaluation Reports
15. **Internal communication.** Information necessary to support internal control is communicated internally.	OSP (corporate performance); OCC (other corporate information);	Managers apply this principle across the entities and individuals under their command. All staff observe FAO policies and procedures on internal communication.	Official communications (Administrative Circulars, DG Bulletins, etc.) FAO In-Touch; Strategic and operational plans Corporate Dashboard; budget reports; End of Biennium Assessment. FAO IT infrastructure (email, GRMS, etc.) Fraud hotline

| Principle | Accountabilities | | Supporting policies and tools |
	Lead unit	Applicability to managers and staff	
16. **External communication**. External communication facilitates the inbound communication of external data, and the outward communication of information to meet the needs of third parties.	OSP (corporate performance); OCC (other corporate information); OIG (allegations)	Managers apply this principle across the entities and individuals under their command. All staff observe FAO policies and procedures on external communication.	Confidentiality Policy Strategic Plan, Medium Term Plan, Programme of work and Budget Annual Financial statements External Audit Opinion and Long Form Report Evaluation Reports FAO web portal, social media, press releases, etc. SOMI FAO IT infrastructure (email, etc.) Fraud hotline
MONITORING			
17. **Monitoring.** On-going and separate evaluations are undertaken to assess the application of the components and principles of internal control.	CPMB, with SPLs, ADGs, Regional Representatives and Business Unit Supervisors	Managers apply this principle across the entities under their command.	FAO Results Framework Accountability Policy Letters of Representation Internal audit reports External audit management letters Office of Evaluation reports
18. **Reporting internal control deficiencies**. Deficiencies in internal control are promptly evaluated and reported to those responsible for corrective action. Corrective action is prompt and effective.	CPMB, with SPLs, ADGs, Regional Representatives and Business Unit Supervisors	Managers and staff apply this principle across the areas under their responsibility.	Delegation of authority Letters of Representation Internal audit reports External audit management letters Office of Evaluation reports