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Agenda item 6

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REPORT OF THE WFP EXTERNAL AUDITOR ON TREASURY MANAGEMENT

NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for consideration.

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

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

NAO
National Audit Office

Report by the External Auditor

International Audit

The National Audit Office (NAO) provides external audit services to the World Food Programme. The External Auditor, Sir John Bourn, has been appointed by the Executive Board in accordance with Article XIV of the Financial Regulations. In addition to providing an opinion on the financial statements of the WFP, he has authority under the mandate to report to the Executive Board on the efficiency of the 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 United Kingdom's Supreme Audit Institution. The NAO has a dedicated team of professionally qualified staff with wide experience of the audit of international organisations.

The aim of the report is to provide independent oversight and assurance to the governments and others; to add value to the organisation's financial management and governance; and, through the audit process, to support the objectives of the organisation's work.

World Food Programme – Review of Treasury Management

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2006-2007

EXECUTIVE SUMMARY

- ***Report on an External Audit review of the management of cash resources.***
- ***Independent assurance to the Executive Board on whether retained funds are safeguarded, managed cost-effectively and available for appropriate use.***
- ***11 audit recommendations for improvements to treasury management arrangements.***

1. Every year since 2002, the World Food Programme (WFP) has retained significant cash resources, in excess of US$1,000 million. The extent of cash balances necessitates effective management control to safeguard these sizeable cash assets and provide WFP with resources to respond rapidly to new emergencies; support ongoing operations; and finance obligations arising from past activity such as staff benefit funding.

2. We carried out an independent audit review of the control and custody of cash balances, and the arrangements for corporate fund management.

3. Based on our examination of the Secretariat's corporate risk management arrangements, key management controls and investment activities, we concluded generally that cash funding is adequately safeguarded; with reasonable returns on investment taking into account the low risk criteria adopted. We have nevertheless presented eleven recommendations to strengthen WFP's corporate fund management, so as to:

   - Improve cash forecasting;
   - Standardise business processes and responsibilities to integrate with standard system tools;
   - Continue to analyse and report regularly to the Executive Board on expenditure and cash balances;
   - Ensure cost effective financial controls over electronic banking and payments;
   - Review the usage of zero balance bank accounts;
   - Confirm the cost efficiency of financial service provision and investment strategies;
   - Continue the refinement of robust, results-based investment performance indicators;
   - Ensure appropriate access to longer term investments according to need;

- Apply periodic evaluation of performance under alternative investment arrangements;
- Establish clear and comprehensively documented guidelines for treasury management; and
- Introduce clearly defined corporate objectives and targets for the treasury management operation.

SCOPE OF THE REVIEW

➢ ***Overview of the audit examination and issues.***

4. In 2002, our predecessors reported on a comprehensive review of treasury management from January 1999 to June 2002, the period since WFP had taken over responsibility for its own treasury management from the Food and Agriculture Organization (FAO). The audit report considered whether WFP had managed its cash in line with the rules, regulations and policies in the most cost-effective way, by matching its inflow with its outflow, minimizing the need to borrow, and maximizing the daily investment surplus.

5. Our predecessors concluded that funds donated and entrusted to WFP had been prudently managed in accordance with executive directives and that the Secretariat had progressively put in place the necessary organisational arrangements and instruments after the transfer of treasury responsibility from FAO on 1 January 1999. Following the strengthening of the Treasury unit with a new chief and an additional officer for investment monitoring, our predecessors considered that WFP was in a position to adopt a more proactive approach on outstanding issues in order of priority:

   - Take-over of the management of long-term assets from the FAO (completed in 2003);
   - Improvement of the accuracy of cash forecasting by the implementation of full functionality in WINGS to maximize investment surplus;
   - The streamlining of field banking arrangements;
   - Review of all treasury-related services through competitive process; and
   - Establishment of a comprehensive policy on foreign exchange.

6. Our present review considered the progress made on these priorities; and identified areas where we believe further action is appropriate in relation to our predecessor’s main recommendations:

   - That WFP should extend the use of zero balance accounts;

- That funds in the money market account should be kept to a minimum to maximize overall returns; and
- That investment guidance should be clarified with benchmarks against which investment manager performance can be assessed.

7. We carried out our audit review against the period 2002-2006, to obtain a reasonable trend analysis of cash balances, income and expenditure; and to assess the adequacy of cash resources over a timeframe which included a variety of operational circumstances.

8. We considered key controls by Secretariat and Finance staff over cash balances including:

- Cash forecasting to identify the level of operational need;
- Monthly senior management review of cash movements;
- Treasury oversight of banking, investment and foreign exchange gains or losses;
- Regular bank reconciliations by Headquarters, regional bureaux or country offices to confirm the accuracy of reported cash balances; and
- Investment Committee oversight of cash balances and returns on investment.

9. This report assesses corporate fund management by considering whether:

- Current treasury arrangements are adequate, and investment or fund management policy is appropriate;
- WFP is getting reasonable returns on funds invested; and
- Performance and risk is adequately and actively managed.

10. The report also comments on corporate risk profiling and the potential impact of fund management on WFP's business process review.

INTRODUCTION AND CONTEXT

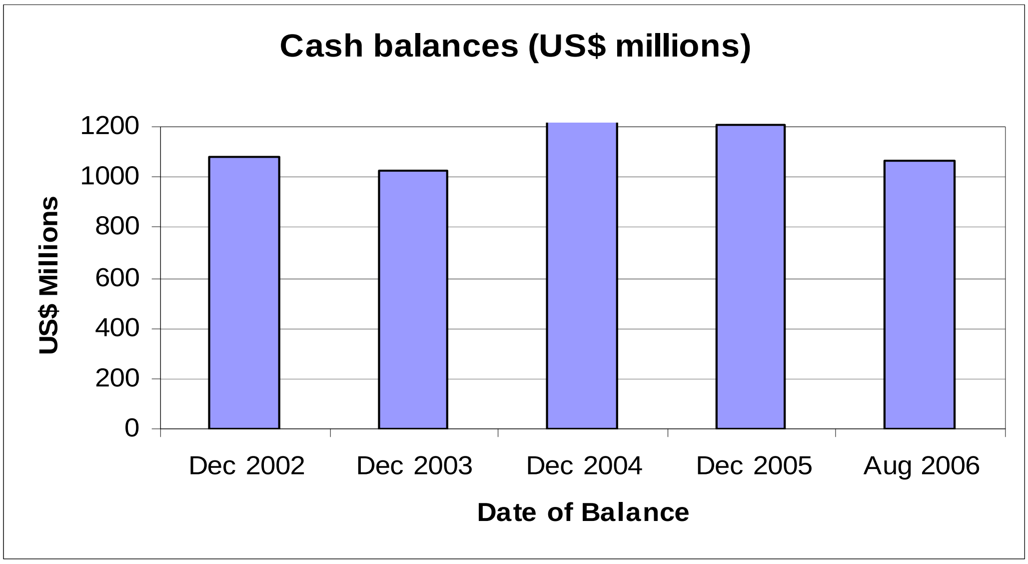
- ***WFP's cash holdings in recent years.***
- ***Where cash is held and spent.***
- ***Initiatives to enhance fund management.***

11. The Secretariat aims to hold adequate funding capacity to respond effectively to up to three concurrent emergencies in addition to financing commitments arising from past activity such as support for after-service medical care.

Cash balances managed by WFP

12. The Programme's cash balances[1] derive only from voluntary contributions or miscellaneous income from investments or activities such as air operations. The Programme manages significant balances which, since 2002, have at the end of every year totalled in excess of US$1,000 million.

Figure 1: Trend of Cash Balances, 2002-2006



Source: WFP Financial Statements and Management Accounts

13. Figure 1 shows cash held by the Programme at the end of each of the last four years and at the time of starting our audit review in August 2006. The balances include earmarked funding for staff benefits and the repayment of a long-term loan, as well as reserves and cash resources which support operations. The financial statements for the last two biennia show that WFP had adequate cash funds to meet its commitments should they have been immediately payable at the end of either biennium: short term investment and cash amounting to US$1.13 billion at the end of December 2005 compared with total payables and obligations of US$907 million (US$884 million and US$ 598 million respectively for December 2003).

14. The Secretariat provided a detailed report on cash cover of commitments at the end of 2005 to the June 2006 Executive Board[2].

[1] Cash in hand; available on demand; in short-term highly liquid investments readily available in known amounts subject to insignificant risk of change in value or in reserve to meet longer-term commitments.

[2] WFP/EB.A/2006/6-H/1

Where does WFP hold its cash?

15. At the end of 2005, WFP's total cash holdings exceeded US$1,208 million[3], as follows:

- US$895 million (74 per cent) in a short-term investment portfolio managed by three external investment companies. In accordance with financial regulation 11.2, the main considerations for these short term investments are security of principal, liquidity and return. The portfolio is therefore restricted to low risk investments including cash and equivalents, treasury bills, corporate and government bonds, and asset-backed securities;

- US$194 million (16 per cent) in bank accounts maintained by Headquarters;

- US$41 million (three per cent) held by country offices for operational purposes, either in local bank accounts or as petty cash;

- US$21 million (two per cent) in country office banks retained in trust, mainly for governments as a result of the sale of food after delivery to the recipient government; the sale of commodities unfit for human consumption; the sale of packing materials and related items; or the recovery of the costs of post delivery food losses; and

- US$57 million (five per cent) in a United States Treasury investment which guarantees repayment of a 30-year commodity loan from a member state.

16. In January 2002, WFP's cash balances had amounted to US$904 million. Country office banks and cash holdings have since increased from US$15 million to US$41 million at December 2005. The proportion of total cash balances managed centrally as short-term investments or retained by Headquarters in bank accounts has also increased by seven per cent: from 83 per cent (US$ 747 million) in January 2002 to 90 per cent (US$1,089 million) at the end of 2005. The comparison shows that although increased cash funding is retained in country offices for local operations, an enlarged central pooling of cash is available for investment.

Where is cash spent?

17. Figure 2 shows the uses to which cash resources were put in the last two biennia, reflected in the financial statements as follows:

- **Commodities purchased** comprise food aid purchased by WFP;

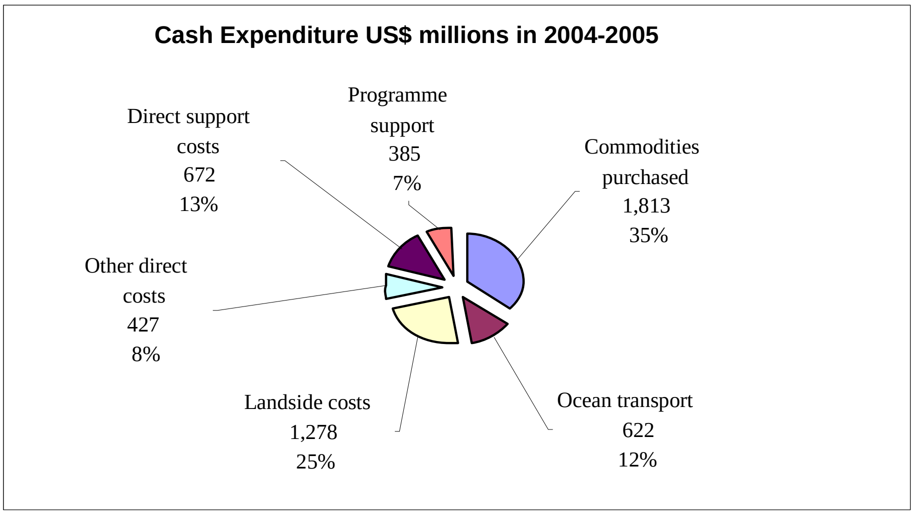
- **Ocean transport** includes the costs of sea transportation of commodities;

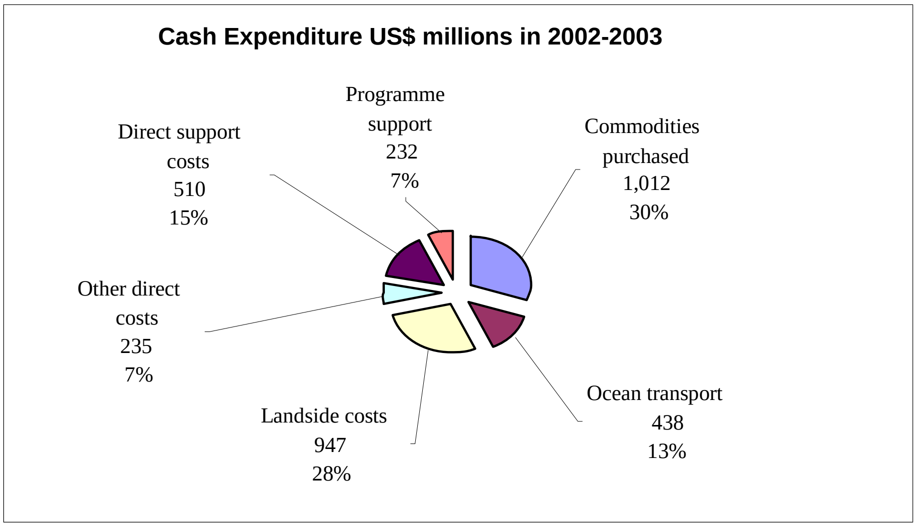
- **Landside costs** are the costs of maintaining and delivering food and other commodities from delivery by external transport (ocean transport for example) to the final destination;

[3] WFP/EB.A/2006/6-A/1/2

- **Programme support** includes the indirect administrative costs of supporting programme activities, such as staffing of procurement, logistics and technical support, which cannot be directly linked to a single operation;
- **Direct support costs** are the variable costs to support country operations, such as local staffing, air transport and equipment, which would not be incurred if that operation ended; and
- **Other direct costs** include variable operational costs related to co-operating parties which also would not be incurred if that operation ended.

Figure 2: Biennial Cash Expenditure





Source: WFP Financial Statements

18. Figure 2 indicates that the main area of growth in the expenditure profile has been the five per cent increase in food commodities purchased as a proportion of the total spend. Other expenditure decreased as a proportion of the total. Direct support costs

decreased by two per cent, with a reduction of three per cent on landside costs as a proportion of the total.

Comparison of cash holdings between organisations

19. In June 2006, the Secretariat prepared an analysis of the relationship between cash balances and cash expenditure for the June 2006 Executive Board[4]. As part of our review, we compared this relationship as at end of 2005 with three United Nations organisations operating worldwide: the Food and Agriculture Organization (FAO), the International Labour Organization (ILO) and the United Nations High Commissioner for Refugees (UNHCR). There are limitations to direct comparison of the adequacy of reserves in organisations with differing mandates, obligations and sources of funding. However, we found that overall cash holdings covered 7.4 months of average expenditure at FAO; 11.1 months at ILO; and 1.4 months at UNHCR. By comparison, the overall cash funding at WFP represented 5.6 months' average cash expenditure.

Importance of treasury initiatives

20. To provide a solid foundation for delivering the five strategic objectives prioritised in the WFP Strategic Plan 2006-2009[5], the Executive Board approved seven management objectives. As part of our review, we examined progress made against three of these objectives:

- Management Objective 5: to provide technical and operational infrastructure services to support effective operations;
- Management Objective 6: to be transparent, accountable and manage risk; and
- Management Objective 7: to raise resources, to ensure that WFP has the resources it needs to fight hunger on all fronts.

21. Since 2005, the Secretariat has taken a number of initiatives with the aim of enhancing treasury management procedures in accordance with these management objectives:

- The appointment of a new treasury manager with commercial banking experience;
- Extension of the Investment Committee, which advises the Executive Director on treasury issues, to include additional external professional advisors;
- Establishment of a new investment policy; and
- The issue of new directives on treasury delegated authorities and foreign exchange management.

[4] WFP/EB.A/2006/6-H/1

[5] WFP/EB.A/2005/5-A/Rev.1

22. At the time of our audit, a new directive awaited approval by the Executive Director to delegate further responsibilities to the treasury management unit, including:

- On cash management – allowing the movement of cash funds between deposit accounts up to a maximum of US$100 million over five days, or between current accounts up to US$200 million over a similar timeframe;
- On investment management - for preparing reports on the performance of investment managers; and
- On foreign exchange movements – approving foreign exchange hedge transactions, or the purchase and sale of currencies individually, up to US$50 million in a period of five days.

23. We therefore examined the effectiveness of treasury and corporate controls which address the specific risks associated with these responsibilities, in particular the risk of:

- Sufficient funds not being available at the time needed and in the appropriate location; or of excessive funds being retained without maximising returns (risk addressed through cash forecasting and management oversight);
- Funds not being safeguarded in appropriate, secure banking locations (addressed by assessment of bank profiles);
- Funds lost through adverse foreign exchange movements (addressed by new hedging guidelines to minimise exposure to foreign exchange losses); and
- Reduced interest on investments (addressed by Treasury and Investment Committee oversight).

MANAGEMENT OF CASH, BANKING AND FOREIGN EXCHANGE

- ***Cash forecasting.***
- ***Banking arrangements.***
- ***Foreign exchange hedging.***
- ***Audit recommendations.***

24. Effective cash management control ensures the timely transfer between secure banking organisations of adequate funds to meet immediate funding requirements. Cash forecasting is therefore an essential treasury activity to ensure the availability of sufficient funding at the right time.

Forecasting cash requirements

25. Treasury forecasts cash requirements to ensure that adequate funds are retained in readily-accessible money market banking facilities. These funds can be transferred without delay for immediate operational requirements. Funds not required for day to day activities are made available for appropriate investment.

26. In July 2006, the Investment Committee expressed concern at the reliability of income forecasts which relied on confirmed contributions without confirmation of receipt dates. At its March 2006 meeting, the Committee also encouraged improved cash flow forecasting through the sharing of information between WFP units.

27. A monthly review of management accounts introduced in 2004 assists cash forecasting by informing management of the potential risks of inadequate funding. The management accounts show the number of months of cash funding available for operating activities (1.4 months at end of August 2006); and the number of months required to convert pledged cash contributions to cash (5.9 months), or to settle accounts payable (1.4 months).

28. In November 2006, the Executive Board took note of the Secretariat's proposal to record expenditure only when the service and goods had been delivered[6]. Effective cash forecasting can be affected by expenditure recording unless payment dates from commitments are recognised in the accounting system at the earliest opportunity.

Recommendation 1: We encourage the Secretariat to ensure that treasury cash forecasts provide adequate support for existing programmes or for immediate operational requirements by:

- **Encouraging understanding in all units of the benefit of promptly sharing information;**
- **The timely recording of expenditure or commitments; and**
- **Encouraging the earliest income notification by donor states.**

Accounting system enhancement to cash forecasting

29. The second priority of the External Auditor's report in 2002 referred to the implementation of functionality in WINGS to improve cash forecasting. Plans for the upgrade to the WINGS accounting system to be implemented in 2008 include enhanced functionality to ensure accurate and timely entry of all cash-flow related transactions (for example purchase orders, invoices, payments, and receipts).

30. The aim of the enhancement is to enable accurate and up to date cash management reports to be generated at a global or local level, to inform cash forecasting and management decision-making. Cash flow forecasting would be supported by standard system tools replacing the existing manual process of data collection, which is time-consuming and increases the risk of incomplete or erroneous entry. A pre-requisite to

[6] 2005/EB.2/11

ensure consistent operation of such tools is that key business processes and responsibilities should be globally standardised wherever possible.

Recommendation 2: We endorse the planned standardisation of cash forecasting and reporting to be implemented by the WINGS accounting system upgrade; and we recommend the global standardisation of procedures, roles and responsibilities, wherever possible, as a prerequisite for consistent forecasting.

Nature of expenditure

31. Cash forecasting and the effective management of funds require a clear view of operational requirements for budgeting and allocation of cash resources. Currently this is hampered because a fully detailed separation of costs by function is not yet readily available from the accounting system, since staff costs can be allocated either to specific projects or land transport support in field locations. Note 15 of the 2004-2005 financial statements disclosed the difficulties with reporting staff costs by function. In 2006, the Secretariat piloted a payroll system in Sudan for field-based staff costs which could address this deficiency.

32. In June 2006, in response to an Executive Board request for a more comprehensive picture of the organisation's costs, the Secretariat provided a 2004-2005 biennium cost overview, which separated food project expenditure from non food projects[7]; and set out an analysis of cash balances. Our financial reports to the Executive Board have noted loans between programme categories and cross-subsidy of programme categories which weaken the robustness of the separation illustrated in the cost overview of expenditure between emergency operations, prolonged relief and recovery operations, development and special operations[8].

Recommendation 3: We encourage the Secretariat to continue to produce the analysis of expenditure in a regular and timely manner, to help inform the governing body on the adequacy of resources provided for WFP core operations and endorse the moves to fully separate staff costs for review.

Banking security

33. As at October 2006, WFP maintained 343 banking accounts holding 70 different currencies in 82 countries to retain funds for global operations or to safeguard reserves. Since the release of a Finance Directive in July 2006[9], the Treasury unit approves the opening of new bank accounts after confirmation by a regional finance officer of the business requirement for the account.

34. The criteria for bank selection are governed by the provisions of the WFP Finance Manual, which wherever possible includes using the same banking network as that operated by the United Nations' Development Programme. Treasury staff assess the

[7] WFP/EB.A/2006/6-G/1

[8] WFP/EB.A/2004/6-B/1/3 and WFP/EB.A/2006/6-A/1/1

[9] CFO2006/003

selected bank's financial security and ability to provide the necessary level of services, using published banking profiles on credit risk before final approval of the opening of the account. Except in exceptional circumstances, Treasury maintains less than one month's operational funds in country banks which are not controlled by Headquarters.

Management of electronic banking

35. Our field visits throughout 2004-2005 and review at Headquarters revealed inadequacies in regional and central oversight over bank reconciliations which we highlighted in our financial report to the June 2006 Executive Board[10]. In addition, we reported that scope remained for the timely clearance of long-standing balancing items between cash in bank statements and the WINGS accounting system; a control which is an essential requirement for effective bank reconciliation to confirm the accuracy of cash balances.

36. The risks associated with inadequate bank reconciliation are increased in the absence of strong controls over electronic banking. We therefore examined actions taken by Finance and Treasury aimed at enhancement of existing financial controls over electronic banking:

- Bank statements are uploaded daily into the WINGS accounting system from 40 country offices, with planned extension to a further 10 countries at the time of our review;
- Pre-formatted vendor authorisation is being introduced to increase financial control over electronic payments by ensuring electronic transfers of cash are made only to system-validated, pre-approved vendors; and
- Internet-based connectivity is being extended throughout banks which operate electronic funds transfer.

37. We **encourage** the increased linkage of country bank accounts to the WINGS accounting system which provides scope for timely monitoring and more effective oversight of long-standing uncleared amounts reconciling bank statements to accounting records. Approval of vendor listings enables a separation of duties between staff approving vendors and those responsible for payment authorisation, enhancing financial control to prevent improper payments.

38. Finance Division has extended electronic banking procedures to 53 zero balance accounts (ZBA) which automatically transfer balances direct to one of three international banks each night; pooling the funds to reduce cash retained without earning interest. ZBA accounts enable effective centralised investment and control of funds otherwise held in many separate accounts worldwide although country offices can still transfer funds from the ZBA accounts to local bank accounts for operational reasons.

39. Our review of ZBA accounting confirmed the benefits of these accounts, the extension of which was recommended in the external audit report in 2002[11]. However

[10] WFP/EB.A/2006/6-A/1/3

[11] WFP/EB.3/2002/5-A/1/3

four of the ZBA accounts had no transactions recorded during the first six months of 2006 and one account was overdrawn by US$470,000 at the end of July 2006. We therefore reinforce the need for financial oversight at regional and central level to ensure the maintenance of reasonable, cost-effective financial control.

Recommendation 4: We welcome the enhanced control procedures being introduced for electronic payments and encourage the extension of timely linkage of banking statements and the accounting system to assist identification of areas of increased fraud risk.

Recommendation 5: We recommend that Finance ensure the cost-effective usage of zero balance accounts which support effective cash management by:

- **Investigating overdrawn accounts in a timely manner;**
- **Ensuring that any bank accounts not required are promptly closed; and**
- **Extending zero balance accounts for any countries on the basis of a business case which would consider the costs of training, communications linkage and the expected volume of transactions passing through the account.**

Foreign exchange hedging

40. The importance of effective oversight of foreign exchange gains and losses is shown by the significant change in currency exchange movements amounting to a total deficit of US$38 million in 2004-2005 biennium compared to a gain of US$60 million in 2002-2003[12].

41. In June 2006, the Executive Director noted[13] the implementation of a foreign exchange hedging strategy for Euro-staff expenditure at Headquarters. Furthermore, the Secretariat released a new Executive Directive in May 2006 setting out roles and responsibilities for foreign exchange management and defining the financial instruments available to hedge against foreign exchange movements[14].

42. Hedging operations are designed to reduce the risk of foreign exchange movement. Our review confirmed that the Directive reasonably addressed risk by disallowing hedging for trading or speculative purposes and limiting its use to:

- The value of the cash flow hedged;
- Banks with which agreements and procedures have been agreed in advance selected from at least three quotations taking into account the credit rating of each bank; and
- Maximum periods of 30 months for each hedge.

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[12] WFP/EB.A/2006/6-A/1/2

[13] WFP/EB.A/2006/6-A/1/1

[14] ED2006/04

MANAGEMENT OVERSIGHT OF INVESTED FUNDS

- ***Management oversight.***
- ***Investment Committee.***
- ***Investment policy.***
- ***Selection of financial service providers.***
- ***Relationship to the business process review.***
- ***Alternative policies.***
- ***Audit recommendations.***

Management oversight of investments

43. The Executive Director delegated the management of the Programme's significant cash resources, including oversight of investment and foreign exchange movements, to WFP's Finance Division. Finance Division's oversight of investment is assisted by an Investment Committee.

44. The Committee advises the Executive Director on investment policy and guidelines; overall investment strategy and the selection and termination of external investment managers, a global custodian[15], external investment committee members and other advisors. It also reviews the performance of external investment managers to ensure compliance with the investment guidelines and examines foreign exchange exposure and electronic banking systems.

45. The importance of effective oversight of investment by the Committee is shown by the termination of the contracts of three of six investment managers over the past four years for under-performance against targets. Two of these terminations occurred in 2005.

The Investment Committee

46. The last external audit review of treasury management had recommended increased professional expertise on the Investment Committee. In accordance with an Executive Director's Circular dated 1 August 2001, the Committee consisted of the Chief of Staff, the Deputy Executive Director of Administration and the Director, Funds Division, attending in a personal capacity with external representation from the World Bank Treasury and the Treasurer of the Food and Agriculture Organization. The

[15] Bank subcontracted to be responsible for safekeeping of investments, settlement of related transactions, collection of income, reclaiming tax and investment valuation.

Director of the Oversight Services Division (OSD) attends the Committee as an observer.

47. At the time of our review, a new executive directive was awaiting signature to revise the membership of the Investment Committee. The new Committee's permanent membership is expected to comprise senior management assisted by external advisors with relevant professional expertise and the Director of OSD as an observer. As the World Bank representative of the Committee has also acted as advisor to the Treasury unit, he may become an observer to assist transparency and avoid conflict of interest.

48. Our examination of the Investment Committee minutes confirmed that it uses its experience and knowledge to effectively oversee cash balances and returns on investment; and informs the Executive Director of its findings. We **endorse** the planned introduction of external support with specialised experience necessary for investment oversight, although any additional costs associated with the expansion of the Committee should be measured against well-defined treasury performance achievements.

New investment policy

49. The primary objective of WFP investment policy is the preservation of the value of resources in United States dollar terms, in accordance with Financial Regulation 11.2. The Executive Director approved a revised investment policy commencing October 2006 to replace the original policy agreed in 1999. Treasury set the main objective of implementing the new investment policy to provide better alignment of the risk profile of WFP short-term investment portfolio to the low acceptable risk tolerance levels of WFP. The policy sets out priorities for investment of funds excluding those related to Staff Benefits.

50. The new policy diversifies the investment portfolio by setting limits on the percentage of WFP funds held by each manager that can be invested for set time periods (investment horizons) in particular types of investment – for example asset-backed securities. The policy lists these eligible investments and sets benchmarks against which investment performance can be assessed for four investment horizons:

- P0 - working capital funds which are required within one day;
- P1 – a short-term portfolio, invested for up to three months;
- P2 - medium-term investment of up to one year; and
- P3 - longer-term investments stable over a period of three years or more.

51. The reformed Investment Committee will continue to ensure compliance with the investment policy.

Selection of financial service providers

52. In 2005 the Investment Committee terminated two of the five investment managers for underperformance against preset percentage benchmarks based on conventional financial investment standards of expected returns from three-month bank deposits. The Programme has retained contracts with the three remaining investment managers

who have managed the short term investments since 2001. To assist transition to the new investment policy, their contracts were extended for a further three-year period without competitive tender. The contracts provide for a 45-day notice of termination by either party.

53. Before reappointment, the Treasury unit discussed with the providers their expertise in managing funds in each of the four investment horizons; and provided the Investment Committee with a review of the suitability of the three managers, based on assessment of their performance since 2001 and a statistical analysis of the risks in allocating the funds in each investment horizon to one or two managers. The Investment Committee advised the Executive Director to extend the investment managers' contracts; and to approve the competitive selection of a fourth investment manager in August 2006, to limit the degree of dependence on any one financial service provider[16].

54. Since the Programme has had to terminate investment managers for underperformance, and in view of the 45-day termination clause by either party, we **endorse** the extension of the number of financial service providers. We also acknowledge that the retention of the existing service providers without competitive tender avoided the risk of change during the introduction of the new investment policy. For transparency, however, we consider that once the fourth investment manager is selected, a rotational competitive tender process would help reinforce the Investment Committee's assessment of performance, and would assist in retention of the most cost-effective investment management.

55. The Investment Committee had welcomed the competitive tender process in 2006 for the global custodian, which also extended the incumbent's contract for a further three-year period from January 2007 but at a reduction in charges estimated to amount to 25 per cent.

Recommendation 6: We recommend that following the appointment of a fourth investment manager by competitive tender, financial service contracts should be subject to periodic competitive tender on a rotational basis, which enables continuity of financial service provision and transparent confirmation of cost efficiency and investment performance .

Investment performance measurement

56. We examined the ongoing development of income targets which aim to provide a robust results-based assessment of performance by the investment managers, taking account of the investment guidelines of WFP. Our predecessors' report on treasury management questioned the choice of the performance measure outlined in the previous investment policy – the expected return from three-month bank deposits – as WFP investment policy allowed for investments of up to five years.

57. The new investment policy sets performance targets which are more closely aligned to the investment horizons by setting benchmarks for each period of investment - for example overnight indexes for funds required within one day, and international

[16] Decision Memorandum 10 August 2006

benchmarks covering investments of one to three years for investment horizons in excess of one year.

Recommendation 7: We encourage the Secretariat to continue the refinement of performance indicators set out in the new investment policy so as to enable investment managers to be reliably and realistically assessed.

Business process review

58. In March 2003, WFP launched a business process review (BPR) designed to maximize the utilisation of project resources and improve the on-time availability of food to beneficiaries, using funds on the basis of forecast contribution[17]. BPR enables cash funding not immediately required by the operations or activities for which it was planned to be used to support more urgent operations for which forecast contributions are yet to be received. On receipt of the forecast contributions, the cash funding is restored to the original operation.

59. The investment of funds for periods of three years or more could conflict with the urgent needs to which donors respond to achieve the first WFP strategic objective – to save lives in crisis situations - and in particular BPR planning for resource allocation. Treasury management informed us that the funds under consideration for investment over three years were specifically earmarked – as self insurance, emerging donor, or operational reserve.

60. One of these funds, the operational reserve amounting to US$57 million, ensures continuity of operations in a temporary shortfall of resources in accordance with financial regulation 10.5. The Board approved the use of this reserve for pilot BPR projects in 2004 and established limits in 2005[18] to which its use could cover forecast contributions which subsequently did not materialise.

Recommendation 8: We recommend the Secretariat ensure that funds which are invested for long periods are recoverable in the event of unforeseen needs that comply with Board-approved usage of particular funding.

Alternative investment policies

61. We examined one alternative investment policy - the retention of funds in bank accounts such as the money market by WFP treasury staff. We were unable to confirm that investment achievements for 2005 exceeded the savings, such as the investment managers’ fees amounting to more than U$970,000, which could be expected from this simpler banking of funds.

62. Our review and discussions with the Treasury unit manager, however, confirmed that over the five-year period 2000-2005, the net return achieved by investments exceeded any savings achievable from the banking of funds.

[17] WFP/EB.1/2006/6-F and WFP/EB.2/2005/5-l/1

[18] WFP/EB.A/2006/6-A/1/2

63. We therefore consider that the investment policy remains cost-efficient, taking into account the low risk criteria for investment, but believe that the Secretariat should confirm that performance resulting from the new policy net of investment fees continues to exceed the results of simpler investment arrangements, over a suitable pre-established timeframe.

Recommendation 9: We recommend that the Secretariat periodically confirms that the performance resulting from the new investment policy net of investment fees continues to exceed the results of more simplified investment banking arrangements.

TREASURY GUIDANCE, PERFORMANCE AND RISK ASSESSMENT

- ***Treasury operation and staffing.***
- ***Rigour of Treasury unit performance assessment.***
- ***Corporate risk assessment.***
- ***Audit recommendations.***

Treasury manual and guidelines

64. In 2002 the previous external audit report on treasury management found that the Treasury unit was not equipped with a comprehensive operating manual more than three years after the Unit's establishment. At the time of our review, the Treasury unit still lacked a comprehensive treasury manual for operations, although it is issuing operating procedures such as the daily cash management released in July 2006[19].

65. In addition, a new directive awaited Executive Director authorisation setting out responsibilities for the management of investments, foreign exchange, cash, and the selection of financial service providers. The Directive clarified responsibilities retained by the Executive Director (such as approval of investment policy); and the coverage of the Investment Committee in advising the Executive Director concerning recommendations on foreign exchange policy for example. It also sets out the delegated responsibilities of the Deputy Executive Director for Administration, the Chief Financial Officer and the Chief of Treasury.

[19] TP 2006-001

66. Our review of the Directive found no evidence of conflict of interest between the Deputy Executive Director's membership of the Investment Committee in a personal capacity and the oversight responsibilities set out in the Directive.

67. We consider the clear definition of responsibility and accountability to be an essential requirement for effective cash management. Guidelines that clearly establish all policies, job descriptions and operational procedures for the treasury operations, including those temporarily covered by consultant support, remain essential when addressing risks associated with key staff absence or reappointment.

Treasury staffing

68. At the time of our review, treasury staffing comprised three budgeted professional posts; one of which was occupied by a consultant and six budgeted general service posts, of which five were occupied. In addition, a consultant and a voluntary staff assistant supported the office. Finance division is considering the section's request for an increased budget to allow one professional post to undertake the work presently covered by the additional consultant. We **encourage** the Secretariat to ensure the implementation of the most cost-effective staffing arrangements in the treasury which maintain operational capacity.

Recommendation 10: In view of the need for clear accountability and the maintenance of Treasury operational capacity, we recommend that key treasury guidance be prepared and approved at the earliest opportunity to:

- **Enable flexibility in staff coverage and training; and**
- **Effectively manage treasury procedures**

Performance assessment of the Treasury unit

69. An annual work plan for the Treasury unit in 2006 clearly defined which treasury staff held responsibility for specific activities within the annual timeframe. Performance of treasury staff is assessed against objectives set out in the work plan with achievement reviewed by the line manager of the staff member responsible for each objective and approved by the Chief Treasury or Chief Finance Officer. The plan represents welcome progress in results-based assessment and sets out the objectives against a corporate management priority - be transparent, accountable and manage risk - approved by the Executive Board in the Strategic Plan 2006-2009[20].

70. Our review of the objectives, however, revealed variation in the clarity of definition which could hinder effective assessment. Well-defined activities included the 'acknowledgement to donors within five days of the clearance of receipts' whereas less clarity existed for 'management of daily cash positions, to ensure liquidity while obtaining the best possible yields by investing funds short term in appropriate working capital instruments'. We also consider that current objectives may lack confirmation that the administrative process is enacted efficiently and cost-effectively to achieve results in accordance with the corporate management priorities.

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[20] WFP/EB.A/2005/5-A/Rev.1

71. Our findings confirm that scope exists for more robust performance assessment against explicit performance targets based on overall corporate goals. Once established, a variance analysis of achievement against results showing those under the control of the management could be verified in Investment Committee reports to the Executive Director.

Recommendation 11: We encourage the Secretariat to introduce clearly defined objectives for the Treasury unit, directed towards the cost-effective achievement of corporate goals, namely:

- **Reductions in percentages of cash held without interest earned at least at the overnight interest rates;**
- **Percentage reduction in losses due to foreign exchange transactions; and**
- **Targets for improved returns on investment taking account of those set for investment managers.**

Corporate risk assessment

72. The Secretariat assesses corporate risk prioritised by the likelihood of occurrence and impact on the Programme. In July 2006, the Audit Committee discussed a draft risk profile and action plan to address each identified risk under three categories:

- External threats, which the Programme cannot prevent such as increased severity or number of emergencies to be addressed by the creation of emergency response capacity;
- Risks which WFP could partially prevent occurring, such as avoiding reputational damage from operational failure to be addressed by strengthened corporate communications and ongoing staff development; and
- Internal risks which are fully preventable such as failure to deploy staff with the right competencies cost-effectively, to be addressed by strengthened succession planning and programme-wide oversight of the cost-efficiency of activities.

73. A risk management handbook was under preparation at the time of our review aimed at increasing awareness of risk management procedures throughout the programme. We **encourage** the ongoing development of corporate risk assessment and have already considered in this report how the Secretariat addresses corporate risks related to the treasury, in particular the reduction of reputational risk by strengthening agreements with cooperating partners; defining treasury staff responsibilities and clarifying Secretariat accountability for investment procedures.

74. In addition, new investment guidelines agreed with financial service providers address reputational risk in relation to investment in organisations deemed inappropriate to WFP objectives by prohibiting investment in organisations periodically notified to them by the Treasury.

OVERALL CONCLUSIONS FROM THE REVIEW

75. Based on our examination of the Secretariat's corporate risk management and key management controls, we conclude that cash funding is adequately safeguarded and that the investment of funds obtains a reasonable return taking into account the low risk criteria for investment.

76. We found that the Secretariat is continuing to develop the necessary policies, organisational arrangements and instruments to prudently manage the funds donated and entrusted to WFP, in accordance with WFP Regulations.

77. The introduction of the commercial experience into the Treasury and the additional investment expertise planned for the Investment Committee should maintain a proactive approach to investment. Finally the enhancement of the WINGS accounting system should reduce the risks of inefficient manual record keeping and provide capacity for programme-wide awareness of effective procedures for fund management.