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RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 6

For consideration

ANNUAL ACCOUNTS (2006): PART II

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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.

Director, Office of the External Auditor:	Mr G. Miller	tel.: 0044-207798-7136
External Auditor, UK National Audit Office:	Mr R. Clark	tel.: 066513-2577

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).

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.

For further information please contact:
Graham Miller
Director , Room A477
National Audit Office
157-197 Buckingham Palace Road,
Victoria, London, SW1W 9SP
+44 20 7798 7136
Email: graham.miller@nao.gsi.gov.uk, gary.heywood@nao.gsi.gov.uk or richard.clark@wfp.org

World Food Programme – preparation of financial statements for 2006 – progress towards IPSAS

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EXECUTIVE SUMMARY

1. In November 2006, the Secretariat confirmed that it would present its unaudited annual financial statements, for 2006 to this Executive Board[1]. These accounts constitute the first steps towards the implementation of International Public Sector Accounting Standards (IPSAS) as the basis for the World Food Programme's financial reporting from January 2008. The Secretariat requested that the accounts preparation be reviewed by External Audit without the provision of an audit opinion. We have undertaken this review and our findings and recommendations are set out in the report. We will provide an audit opinion on the 2006-2007 biennium financial statements to be presented to the June 2008 Executive Board.

2. This report covers four key areas of the Secretariat's programme for implementing IPSAS drawing on the lessons to be learnt from preparing the annual accounts for 2006 and looking forward to potential changes in accounting policies and other changes, for example to the management information systems, which may be necessary to ensure IPSAS compliance. We also examined the arrangements for managing the IPSAS implementation and maintained close liaison with the IPSAS project team particularly on emerging issues and accounting policy developments throughout the year.

3. We provided the IPSAS project team and members of the Secretariat with copies of the IPSAS Compliance Guide prepared by the UK National Audit Office. The Compliance Guide is designed to assist in managing the transition to the IPSAS accounting framework and includes checklists against which to assess the compliance of disclosures with IPSAS. The Guide forms part of our commitment as External Auditors of the WFP to support the organisation in improving its financial reporting, and facilitating better decision-making, financial management and good governance.

4. The Secretariat has done well to produce the annual financial statements for 2006 in such a timely fashion. This provides a good basis for moving to IPSAS but the identification of the required changes to accounting policies and systems requires robust and strong project management. We have identified two key risks to the smooth transition and implementation of IPSAS which we believe the Secretariat has to address. These relate to ensuring increased staff awareness of the requirements of IPSAS and the timetable for implementation of the upgraded "IPSAS compatible" accounting system. We also consider that internal controls in the area of financial management and reporting will need to be improved given the additional rigour needed to prepare financial statements under IPSAS from 2008.

5. The Secretariat has taken action to achieve improvements in the quality and reliability of the Programme's accounting and financial reporting; including the recognition of expenditure when goods or services are delivered and the provision of annual financial statements. In accordance with our programme of work presented to the November 2006 Executive Board[2], our review includes a number of observations and recommendations intended to be of benefit to the Executive Board and Secretariat in

[1] WFP/EB.2/2006/5-A/1

[2] WFP/EB.2/2006/5-E/1

strengthening management control over the preparation of the disclosures in the financial statements. We have made seven recommendations directed towards:

- Effective and timely management review in the preparation of the financial statements;
- Continued action to resolve outstanding UNDP accounts;
- Compliance with IPSAS requirements for recognition of the full cost of staff services;
- Timely completion of financial management control over the preparation of the financial statements;
- Improved reporting of vendor balances in compliance with accounting standards;
- Rigorous allocation of income and expenditure to the appropriate financial accounting period; and
- Timely preparation of the 2008 financial statements in accordance with International Public Sector Accounting Standards (IPSAS).

BACKGROUND

6. The United Nations has agreed to implement International Public Sector Accounting Standards as the basis of its financial reporting from 2010. At its meeting in June 2006 the Executive Board agreed that the World Food Programme should implement IPSAS from January 2008. From the same date the Programme will move from a biennial to an annual accounting period. As a result the Executive Board will receive audited financial statements on an annual basis. The World Food Programme has put in place a programme of work:

- identifying the changes in its accounting policies that will be necessary in implementing IPSAS;
- identifying and adjusting its systems to gather the required information in a usable form; and
- reviewing its administrative systems to ensure that it is well placed to produce its financial statements in a timely fashion on an annual basis.

7. As a first step in the process the World Food Programme decided to produce annual financial statements for 2006 based on its existing accounting policies which are the current UN System Accounting Standards (UNSAS). The Secretariat has submitted these accounts to the Executive Board for approval as a document. These accounts are unaudited as under the Financial Regulations the Programme currently works on a biennial reporting cycle. However while we have not completed all of the procedures necessary to provide a full audit opinion to the requirements of the International Standards on Auditing we have reviewed the Secretariat's systems for preparing the statements. On the basis of the review we have provided a management letter to the

Secretariat and the report to the Executive Board on the Programme's preparations for implementing IPSAS. Our approach and work has been specifically designed to consider the accounting policy changes required to ensure IPSAS compliance and the impact of these policy changes on systems and management processes. Our review examined four aspects of the Secretariat's programme for implementing IPSAS as follows:

- the lessons arising from the preparation of annual accounts for 2006;
- the changes to accounting policies flowing from IPSAS implementation and their impact;
- the development of financial systems to support IPSAS; and
- the arrangements for managing the IPSAS implementation project.

LESSONS OF 2006 PREPARATION OF FINANCIAL STATEMENTS

8. While the Secretariat continues to improve the quality and robustness of the information reported in the financial statements, reliability of some of the supporting data still requires rigorous review. We identified a number of significant issues required in the financial statements initially presented to us for review which required amendment. In total we identified adjustments (gross) amounting to US$255 million which have been corrected prior to the presentation of the financial statements to the Executive Board. These adjustments reduced the reported reserves and fund balances by US$220 million from US$2,427 million to US$2,207 million (a reduction of nine percent), and mainly related to the:

- Lack of timely completion of management review prior to presenting the draft statements for audit,
- Allocation of income and expenditure to inappropriate financial periods; and
- Insufficient review of the financial statements to ensure compliance with accounting system records and disclosure requirements.

9. The extent of the presentational and policy changes and the timeframe for the preparation of annual financial statements required effective management review of the financial results to reduce the need for subsequent adjustment to schedules, disclosures and figures as a result of audit review. Our review identified adjustments in excess of US$12 million required to the unused fund balances reported in Note 15 which had remained undetected by management prior to the release of the financial statements.

Recommendation 1: ***As part of the accounts planning process, we recommend that the Secretariat establish timely and effective quality review of the financial statements prior to submission for audit.***

10. We reviewed initially the Secretariat's response to the areas of concern which had been highlighted in our report on the 2004-2005 financial statements[3]:

- We found that bank reconciliation processes, a fundamental management control over the propriety and validity of accounting records, including the prompt clearance of balancing items between cash in bank statements and the WINGS accounting system were completed in a more timely and robust manner. At the end of 2006, balancing items in bank reconciliations amounted to a gross value in excess of US$165 million (US$13 million net), of which US$6 million (US$0.6 million net) had remained outstanding for more than 90 days. By comparison, at the end of 2005 a gross value of US$452 million had remained outstanding of which US$21 million had remained for more than 90 days and US$30 million for more than one year.

- Our report on the 2004-2005 financial statements noted the significant number of longstanding records of payments made on the Programme's behalf by the United Nations Development Programme (UNDP) which had not been matched to the Programme's records. At the end of 2006, as a result of the considerable efforts made to reconcile records of UNDP and WFP, a balance of US$8 million (reduced from US$30 million at the end of 2005) comprising in excess of 30,000 transactions of gross value US$48 million (US$100 million in 2005) awaiting matching. Some US$3.5 million (gross US$21 million) had remained outstanding for over 12 months. Note 6 to the financial statements shows WFP has referred US$4.9 million of these payments back to UNDP for analysis and adjustment.

11. We welcome these improvements to essential financial controls but given the annual requirements of financial reporting under IPSAS, there remains considerable scope for further improvement.

Recommendation 2: ***We recommend the Secretariat continue its efforts to clear outstanding items from the UNDP account to provide assurance that records of expenditure are complete and payments valid.***

ACCOUNTING POLICY CHANGES

12. The adoption of IPSAS brings with it more stringent requirements to identifying and applying accounting policies in a consistent manner. Following the policy change of

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

reporting annual investments at market value introduced last year, the Secretariat introduced a further change of accounting policy in 2006 as part of the progression towards IPSAS, in particular to recognise expenditure when services or goods are provided or where legal obligations require payment.

13. We support this policy change which complies with generally accepted accounting practices and enhances financial management by reducing the risk that invalid obligations reserve funding at the end of an accounting period. In 2004-2005 obligations amounting to in excess of US$1 million had been cancelled from 2002-2003 because they were no longer valid.

14. In previous biennia expenditure had also included the total of unpaid purchase orders at the end of the accounting period. Purchase orders for goods and services not received at the end of an accounting period are now reported as commitments amounting to US$496 million in Note 2E2. Note 3C discloses the adjustments made to prior period figures to assist comparison of results with 2004-2005.

Staffing Costs under International Public Sector Accounting Standards

15. As disclosed in Notes 2F and 12B, staff-related liabilities such as accrued leave and termination indemnities are expensed when paid. The estimated liability amounted to US$31.4 million of which professional and Rome-based general service staff liabilities totalled US$17.9 million and field staff administered by the United Nations Development Programme, US$13.5 million.

16. Under IPSAS expenditure should be recorded when the related service has been provided or a legal obligation for payment exists. Since accrued leave and termination benefits arise from past service of the staff member, we consider the liabilities should be expensed as part of IPSAS in 2008 with a provision recorded in the accounts until payment is actually made. Such accounting has funding implications but provides a more accurate assessment and comparison of the staffing costs in a particular accounting period.

> **Recommendation 3:** ***We recommend that the Secretariat ensure compliance with the International Public Sector Accounting Standards requirement for recognition of staff service which have been provided prior to the end of an accounting period.***

17. IPSAS will require further consideration of accounting policies, for example related to the recognition of income. Currently WFP records Headquarters accommodation as a trust fund since it recovers amounts paid for rent and maintenance from the host government. The financial statements record any outstanding balances in the statement of assets and liabilities without recording the services as income and expenditure.

18. This trust fund recording of accommodation costs meets the policy notes recorded in the financial statements. At the time of our review, the Secretariat had been reviewing the compliance of this policy and others to IPSAS, under which revenue comprises the inflow of economic benefits which result in an increase in net assets.

19. As indicated in our report to this Executive Board on the cost of profile raising, WFP receives unforeseen contributions of services-in-kind such as advertising for which the benefits of increased net assets in the form of funding and resources may only arise over a number of years. We therefore encourage the Secretariat to maintain its ongoing review of accounting policies with the aim of ensuring that the recording of revenue and expenditure fully complies with the requirements of IPSAS.

DEVELOPMENT OF FINANCIAL SYSTEMS TO SUPPORT IPSAS

20. The implementation of IPSAS requires the implementation of accounting systems which provide an effective platform for the accurate recording of the additional disclosures in accordance with the accounting standards. The preparation of annual financial statements will also require effective application and robust oversight of existing financial controls. Our review identified scope for enhancement of the operation of the financial system.

Timely Completion of Financial Control

21. Contributions are recorded into the resource management system (RMS) as soon as WFP becomes aware of an expected contribution. Once WFP obtains written confirmation from the donor, the pledged amount is uploaded from RMS as income into the WINGS accounting system. At the end of each financial period the RMS and WINGS records are reconciled to provide assurance that all income is recorded accurately to the financial statements.

22. The 2006 reconciliation was completed only after the financial statements were issued, as a result of our review we found that an overstatement of income and contributions receivable amounting to US$69 million had not been adjusted in the accounts. The overstatement resulted from a known system error which duplicated funding records uploaded into WINGS. The system weakness should be resolved after the upgrade to WINGS II scheduled for 2008.

23. Our review further revealed the understatement of assets and liabilities in excess of US$14 million arising from the netting off of vendor receivables and payables in contravention of United Nations accounting standards. The misstatement arose when officers omitted to enter necessary details when recording the recovery of a receivable as a result of which the accounting system recorded a new payable rather than cancelling the receivable. Following our review Finance agreed to prepare additional staff guidance on the recording procedures and from 2007 strengthen the monitoring and feedback of vendor recording if officers do not complete procedures fully.

24. We conclude that there remains scope to enhance the management control procedures which provide assurance over the accounting figures prior to the management review of the financial results.

Recommendation 4: ***As part of the accounts preparation planning, we recommend that the Secretariat coordinate timely completion of management controls which allow for effective management quality review of the financial statements, prior to submission for audit.***

Recommendation 5: ***We recommend that the Secretariat ensure that robust monitoring of the cancellation of vendor balances be maintained to ensure that assets and liabilities are accurately reported in accordance with the relevant accounting standards.***

Income and Expenditure Allocation Recording to Financial Periods

25. The successful move to international public sector accounting standards will require the rigorous allocation of income and expenditure to each annual financial accounting period. An accurate allocation of income and expenditure to the appropriate financial reporting period is an essential aspect of corporate governance which enables robust assessment by the Executive Board of the Secretariat's stewardship of WFP assets; effective comparison between accounting periods; and a reduction of the risk of meeting budgets or achieving performance targets only through inappropriate recording.

26. Our examination of the allocation of income and expenditure revealed that more robust procedures are required to ensure the allocation of income and expenditure to annual financial periods. We identified:

- Income amounting to US$101 million for which the written confirmation of the donation had been dated in 2007 but was actually recorded to 2006; and
- Expenditure amounting to US$46 million for which the service or goods had been delivered in 2006 although the expenditure had been recorded to the 2007 accounting period. The postings mainly arose because records were reported on delivery of the vendor's invoice rather than when the service had been completed, which contravened Finance Division guidance and the new policy of recording expenditure when a service is delivered.

Recommendation 6: ***We recommend that the Secretariat reinforce the allocation of income and expenditure to appropriate accounting periods by:***

- ***Considering a shorter period for income and expenditure to be recorded after the end of each year before closure of the accounting records and preparation of the financial statements;***
- ***Ensuring income and expenditure is recorded to the accounting period evidenced by the accounting records; and***
- ***Reissuing guidelines with lessons arising from the preparation of the 2006 financial accounts.***

27. One of the objectives for the WINGS II project is to implement a system which is capable of preparing IPSAS-compliant financial statements, with additional functionality for inventory, capital assets and other additional disclosures required by the new accounting standards.

IPSAS PROJECT MANAGEMENT

28. To progress the initiative the Secretariat established an IPSAS project team with the Deputy Executive Director, Administration as project sponsor. The team closely liaises with the United Nations Task Force on Accounting Standards which is establishing accounting guidelines on areas of significance. In particular the WFP IPSAS team has advised the Task Force on the valuation of inventory including WFP food commodity stock which in accordance with IPSAS will be disclosed in the financial statements for the first time in 2008 and may represent a significant WFP asset. At the end of March 2007, the guidelines on eleven other accounting areas including employee benefits, revenue, financial instruments and foreign exchange were under review by the Task Force. A critical success factor will be to ensure that the financial information required for IPSAS compliant statements can be linked/provided through the upgraded accounting system WINGS II.

29. We have maintained close liaison with the IPSAS project team providing the IPSAS team and Secretariat with copies of the IPSAS Compliance Guide prepared by the UK National Audit Office, which forms part of our commitment as External Auditors of the WFP to support the organisation in improving its financial reporting, and facilitating better decision-making, financial management and good governance.

30. We consider there are two key risks associated with the schedule for implementation of international public sector accounting standards:

- Awareness of the separate disclosure requirements in offices worldwide; and
- The concurrent WINGS II implementation.

31. To address the first risk, the Secretariat maintains periodic regional finance meetings to update staff on IPSAS requirements and has established a website to inform staff. In March 2007, the IPSAS team had commenced planning a staff training schedule for IPSAS in coordination with the WINGS II staff training. We plan to examine field office understanding and awareness of the requirements of IPSAS implementation as part of our field visits scheduled for 2007.

32. Considering the WINGS upgrade, the expected go-live time of WINGS II is end of March 2008; three months after the implementation date for IPSAS. Current planning had been to replace the old system with the new system without parallel running. During the three-month period January to March 2008 there will be a number of management priorities for finance including the preparation of biennial financial statements covering 2006-2007 and training for WINGS II implementation. Following the implementation of WINGS II, transactions recorded between January and March 2008 may require different recording to the earlier accounting system; which

could impact the successful migration of information between the systems unless transactions are re-entered into the new system.

Recommendation 7: ***We encourage the Secretariat to ensure that the*****:**

- ***Schedule for implementation of WINGS II enables adequate time for the establishment of auditable financial statements at the end of 2008 which comply with international public sector accounting standards; and***

- ***Accounting difficulties identified during our financial review of the financial statements for 2006 are fully addressed and communicated to staff.***