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**Executive Board
Annual Session**

Rome, 12–16 June 2006

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 6



Distribution: GENERAL

WFP/EB.A/2006/6(A,C,D,E,F,G,H,I,J,K)/2

10 June 2006

ORIGINAL: ENGLISH

REPORT OF THE ADVISORY COMMITTEE ON ADMINISTRATIVE AND BUDGETARY QUESTIONS (ACABQ)

The Executive Director is pleased to submit herewith the report of the ACABQ pertaining to WFP. The report covers the following agenda items:

- Audited Biennial Accounts 2004–2005 (WFP/EB.A/2006/6-A/1/1,2,3)
- Review of Indirect Support Costs Rate (WFP/EB.A/2006/6-C/1)
- Review of the Results-Based Management Framework for Monitoring and Reporting Results: Report by the WFP External Auditor (WFP/EB.A/2006/6-D/1)
- Progress Report on the Recommendations of the External Auditor (WFP/EB.A/2006/6-E/1)
- Report of the Inspector General (WFP/EB.A/2006/6-F/1)
- Analysis of WFP Cost Components (WFP/EB.A/2006/6-G/1)
- Report on WFP's Cash Balances (WFP/EB.A/2006/6-H/1)
- Second Progress Report on the Implementation of International Accounting Standards (WFP/EB.A/2006/6-I/1)
- Report of the Executive Director on the Utilization of Contributions and Waivers of Costs (General Rules XII.4 and XIII.4 (g)) (WFP/EB.A/2006/6-J/1)
- Update on the WFP Management Plan (2006–2007) (WFP/EB.A/2006/6-K/1)

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AC/1594

Advisory Committee on
Administrative and Budgetary Questions

8 June 2006

Dear Mr. Morris,

Please find attached a copy of the report of the Advisory Committee on your submissions concerning:

- Audited Biennial Accounts 2004–2005 (WFP/EB.A/2006/6-A/1/1,2,3)
- Review of Indirect Support Costs Rate (WFP/EB.A/2006/6-C/1)
- Progress Report on the Recommendations of the External Auditor (WFP/EB.A/2006/6-E/1)
- Review of the Results-Based Management Framework for Monitoring and Reporting Results: Report by the WFP External Auditor (WFP/EB.A/2006/6-D/1)
- Report of the Inspector General (WFP/EB.A/2006/6-F/1)
- Report on WFP's Cash Balances (WFP/EB.A/2006/6-H/1)
- Analysis of WFP's Cost Structure (WFP/EB.A/2006/6-G/1)
- Second Progress Report on the Implementation of International Accounting Standards (WFP/EB.A/2006/6-I/1)
- Update on the WFP Management Plan (2006–2007) (WFP/EB.A/2006/6-K/1)
- Report of the Executive Director on the Utilization of Contributions and Waivers of Costs (WFP/EB.A/2006/6-J/1)

Mr. James T. Morris
Executive Director
World Food Programme



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I should be grateful if you could arrange for the report to be placed before the Executive Board at its forthcoming session, as a complete and separate document. A printed version (in all languages) of the document should be provided to the Advisory Committee at the earliest possible opportunity.

Yours sincerely,

Rajat Saha
Chairman



WORLD FOOD PROGRAMME

Financial and Budgetary Matters

Report of the Advisory Committee on Administrative and Budgetary Questions

1. The Advisory Committee met with the representatives of the Executive Director of the WFP to discuss the following reports to be submitted to the Executive Board at its next session:

- for approval, the audited biennial accounts for 2004/05 (WFP/EB.A/2006/6-A/1/1, 2 & 3); the review of the indirect support costs rate (WFP/EB.A/2006/6-C/1); the second progress report on the implementation of international accounting standards (WFP/EB.A/2006/6-I/1); and the update on the WFP management plan for 2006/07 (WFP/EB.A/2006/6-K/1);
- for consideration, the review of the results-based management framework for monitoring and reporting results (WFP/EB.A/2006/6-D/1); the progress report on the recommendations of the external auditor (WFP/EB.A/2006/6-E/1); the report of the inspector general (WFP/EB.A/2006/6-F/1); the analysis of WFP cost components (WFP/EB.A/2006/6-G/1); and the report on WFP's cash balances (WFP/EB.A/2006/6-H/1);
- for information, the report of the Executive Director on the utilization of contributions and waivers of costs (WFP/EB.A.2006/6-J/1).

Audited Biennial Accounts 2004–2005

2. The audited biennial accounts of WFP for 2004/05 comprise the report of the Executive Director on the financial administration of the WFP (WFP/EB.A/2006/6-A/1/1), the opinion of the external auditor and the audited financial statements (WFP/EB.A/2006/6-A/1/2), and the long-form report of the external auditor on the audit of the financial statements of the WFP (WFP/EB.A/2006/6-A/1/3).

3. In his report on the financial administration of the WFP (WFP/EB.A/2006/6-A/1/1 para. 56), the Executive Director indicates that write-offs in the amount of \$7.6 million were financed from the General Fund during the 2004/05 biennium, in accordance with financial regulation 12.4, including contributions (\$2.9 million) and accounts receivables (\$4.7 million). It is indicated in paragraphs 41-42 that the write-offs result from over-expenditures incurred in projects in 2000 and 2001 arising from: insufficient budgetary control in offices that were not using the WFP Information Network and Global System (WINGS); the absence of detailed information on receivables balances migrated from old systems in 2001; and 1997-2001 contributions against which expenditures had been incurred but from which reimbursements could no longer be expected because the projects had been closed.



4. The External Auditor notes that the WINGS system was operational on a worldwide basis for the first time during the 2004/05 biennium and that significant efforts were required to ensure more transparent and robust financial information. He has placed an unqualified opinion WFP's financial statements for the 2004/05 biennium and indicates in his long-form report (WFP/EB.A/2006/6-A/1/3) that and that no weaknesses or errors considered to be material to the accuracy, completeness and validity of the accounts were uncovered during the audit of the WFP's accounts for the 2004/05 biennium.

5. The Advisory Committee recommends that the Executive Board approve the 2004/05 Biennial Financial Statements of WFP and the Report of the External Auditor, and that it take note of the funding from the General Fund of \$7.6 million during the biennium for the write-off of contributions and accounts receivables.

6. The External Auditor has made ten recommendations, aiming to support the efforts of the Secretariat to achieve improvements in the quality and reliability of WFP's accounting and financial reporting as it works towards compliance with international accounting standards. The first recommendation, concerning the formal acknowledgment of the Audit Committee, requires an action by the Executive board. The Committee notes that these ten recommendations have been included in the progress report on the implementation of the External Auditor's recommendations on 2004/05 operations (WFP/EB.A/2006/6-E/1) with an initial response of the Secretariat, indicating that all recommendations have been accepted.

7. The progress report on the implementation of the External Auditors recommendations includes information on the recommendation, the response of WFP and the actions taken by the Secretariat as at December 2005 and May 2006. With respect to the recommendations marked as having been completed, the Committee is of the view that it would be useful if the progress report could be enhanced to include a new column on the observations of the External Auditor, in particular, whether the completed status has been verified and accepted by External Auditor.

Review of the Results-Based Management Framework for Monitoring and Reporting Results: Report by the WFP External Auditor

8. In the review of the results-based management (RBM) framework for monitoring and reporting results (WFP/EB.A/2006/6-D/1), the External Auditor concludes that the framework provides a sound basis for the on-going development of RBM, a strong linkage between WFP's strategic plan and the Millennium Development Goals, and a comprehensive coverage of significant areas of work of the Organisation. The areas identified for improvement include the needs of stakeholders and the collection of reliable data against which performance can be assessed.

9. In this connection, the Advisory Committee notes that the report of the Joint Inspection Unit (JIU/REP/2004/6) on the implementation of results-based management in the United Nations Organisations offers a comparative analysis of the different approaches adopted across the System. The Inspectors indicate that, with UNDP and UNFPA, WFP has been among the organizations with the most methodical and systematic approach in its implementation of results-based management, based on a clearly developed framework, as a broad management strategy aimed at achieving changes in the way it operates.



10. The Inspectors also point out the difficulties of using a common approach within the United Nations System, given the different terminology and definitions used by the organisations. While the Committee recognizes that each agency has its own specific activity, management tools and culture, it stresses the importance of using a common set of basic terms and methods across the United Nations System. This would provide Member States greater transparency and facilitate comparisons between resources required and results obtained across the different agencies and the setting of priorities.

Update on the WFP Management Plan (2006–2007)

11. In the update on the management plan for 2006/07 (WFP/EB.A/2006/6-K/1) the Executive Director requests the Board to approve the transfer of \$20 million to the Immediate Response Account from the Programme Support and Administration (PSA) equalization account. The Committee notes from Table 4 of the same document that the updated opening balance of the PSA equalization account on 1 January 2006 was \$122 million and that it is projected to amount to \$77 million at the end of the biennium. In this connection, the Committee notes that the determination of an appropriate target level for the PSA equalization account is discussed in detail in the document on the review of indirect support costs rate (WFP/EB.A/2006/6-C/1, Section 7) (see also paras. 14 to 17 below).

12. It is also proposed to allot up to \$3.7 million from the PSA equalization account to ensure timely implementation of International Public Sector Accounting Standards (IPSAS). Upon request, the Committee was informed that this amount is destined essentially for capacity building and training. It includes resources for professional staff positions which are expected to be retained after implementation of IPSAS and funding for the training of field staff in new business processes which are expected to be aligned to the new accounting policies on fixed assets, inventory valuations and staff benefits. A breakdown of the cost components of the amount of \$3.7 million requested is provided in Table 1 of the Second Progress Report on the Implementation of International Accounting Standards (WFP/EB.A/2006/6-I/1) (see also paras. 18 to 21 below).

13. The Advisory Committee recommends acceptance of the proposals of the Executive Director contained in paragraphs 33 of the report on the update of the management plan for the current biennium.

Review of Indirect Support Costs Rate

14. In accordance with the decision of the Executive Board during its second regular session of 2005 (2005/EB.2/9) to review the Indirect Support Costs rate (ISC) recovery rate at the 2006 annual session and which requested the Secretariat to evaluate the benefits and consequences of applying a fixed ISC rate as opposed to a rate based on actual costs, the Executive Director is submitting an analysis of Indirect Support Cost (ISC) income compared to Programme Support and Administrative (PSA) expenses during the 2004/05 period and a proposal for a methodology for setting the ISC rate (WFP/EB.1/2006/6-C/1). The Committee recalls that a preliminary review of the ISC rate modalities had been presented in February 2006 (WFP/EB.1/2006/6-A/1).



15. The report provides an analysis of ISC income and PSA expenditure during the 2004/05 biennium and over a ten-year period, the key factors that lead to discrepancies between ISC income and PSA expenditures, the benefits and drawbacks of equalizing ISC income and PSA expenditure within a single period or over a more protracted length of time and an approach towards mitigating the risk of a shortfall between ISC income and PSA expenditure to the Organization. The Executive Director proposes a methodology for setting the ISC rate for each biennium on the basis of the latest available audited financial statements, taking into account changes in the cost structure and the forecast level of contributions for the planned biennium, as well as the opening balance and target level of the PSA equalization reserve. The Advisory Committee commends the Executive Director on the comprehensive, clear analysis provided in this report.

16. The Advisory Committee notes that the target level for the PSA equalization reserve is proposed at four months of indirect expenditures, or \$66 million for the 2006/07 biennium. The ISC rate calculated for the 2006/07 biennium on the basis of this methodology would be 7.25 percent. Taking into account the ISC income (\$53 million) and the planned PSA expenditure (\$51 million) for the first quarter of 2006 and the administrative difficulties in changing the ISC rate in the middle of a biennium, the Executive Director proposes to maintain the current ISC rate of 7 per cent.

17. The Committee recommends that the Executive Board request the Secretariat to apply the methodology proposed for establishing the ISC rate in future Management plans, approve the proposal to maintain the ISC rate for the 2006/07 biennium at 7 per cent and take note of the target level of the PSA equalization account of \$66 million for the current biennium.

Second Progress Report on the Implementation of International Accounting Standards

18. The Executive Board is requested to approve the adoption of International Public Sector Accounting Standards (IPSAS) by WFP with a planned implementation date of 1 January 2008 (WFP/EB.A/2006/6-I/1). The Chief Executives Board for Coordination has endorsed a recommendation of the High Level Committee on Management for adoption of IPSAS throughout the United Nations system, with a phased implementation in which a few pilot organizations such as WFP would implement the Standards effective 1 January 2008 while the majority of organizations would implement effective 2010. Coordination among the United Nations system organizations will be assured by the United Nations Accounting Standards Project, under the auspices of the Finance and Budget network of the HLCM.

19. As indicated in the report, a business plan and budget for IPSAS implementation at WFP have been established, a project manager has been designated and project was launched at the beginning of 2006. The project has major implications for the accounting, budgeting, financial reporting practices and management information systems of WFP. The Committee was informed that it is the WFP strategy to integrate the adoption of IPSAS into the upgrade of the WFP Information Network and Global System (WINGS II) project. In fact, the decision to adopt IPSAS put the WFP in a better position to upgrade WINGS to a new version of the SAP software package, since it eliminated the requirement for considerable customization of the software programs for compliance with United



Nations System Accounting Standards. Both the IPSAS and WINGS II project teams will closely coordinate their efforts.

20. The Committee notes that the implementation of IPSAS will require amendments to the financial regulations that will be submitted to Executive Board, in accordance with the General Regulations, General Rules and Financial Regulations of WFP. The Committee stresses the importance of ensuring system-wide coordination on these matters, through the mechanisms established by the HLCM, as well as the sharing of knowledge and experiences with the other organizations of the United Nations system, which are or will be undergoing a similar process. The lessons learned by WFP as the first Organization to transition to IPSAS, combined with the experience acquired in the implementation of a more standard version of the SAP ERP software package, will be particularly valuable to the organizations of the United Nations system.

21. The Committee recommends that the Executive Board approve the adoption of IPSAS by WFP for its financial statements with a planned implementation date of 2008 as well as the estimated cost of implementation of IPSAS in WFP of \$3.7 million.

Report of the Inspector General

22. The report of the Inspector General (WFP/EB.A/2006/6-F/1) provides information on the Oversight Services Division (OSD) and its resources; the audit, investigation and inspection activity undertaken; the management challenges highlighted by (ODS) and the response of the Management of the Organisation; losses and recoveries; follow-up of best practices; cooperation with other oversight units and host governments; and a preview of the work planned during the current biennium.

23. In paragraphs 41-42, the Inspector General highlights the responsiveness and engagement of WFP Management in following-up on the recommendations of OSD and an approach based on cooperation between OSD and senior management for resolving oversight issues. The Committee notes with interest the level of coordination with external auditors and other oversight agencies described in paragraph 48 of the report.

24. The Inspector General indicates in paragraph 37 that the losses documented in the 2004/05 biennium amounted to \$8.8 million, a significant increase over those reported in the previous period. The Committee recalls the External Auditor had made ten recommendations for strengthening controls following his review of the Arrangements for reporting post-delivery food losses to the Executive Board, and notes that three of these recommendations had been completed as of 31 March 2006.

25. A summary the significant cases and investigations conducted by ODS during the biennium is provided in Annex III of the report of the Inspector General. The Committee is of the view that it would be useful if the summary could be adapted to indicate whether the case concerns international or local staff.



26. The Advisory Committee is concerned by the Inspector General's findings with respect to procurement. In paragraphs 29-30 he indicates that a number of weaknesses in procurement practices were brought to the attention of management, including, the absence of formal procurement procedures for contracting ocean freight; the necessity for updating guidance manuals for both food and non-food items; the absence of formal procedures for the selection of suppliers; inadequate compliance with pre-award reporting requirements; and the lack of adherence to rules, regulations and delegated authority, particularly in emergency situations. He indicates that WFP Management agreed to further strengthen controls by making the Committees on Commodities, Transport and Insurance and the Headquarters Food Purchase Committee more proactive and relevant and to issue updated manuals and guidelines.

27. The weaknesses noted by the Inspector General are serious, and, in the view of the Committee, point to systemic deficiencies in even basic, fundamental control mechanisms. Given the highly decentralized organizational structure of WFP, which operates across widely dispersed geographical settings in some 80 countries, often under difficult conditions, with procurement levels at over three billion dollars, the risks of fraud, waste, mismanagement and abuse cannot be underestimated. It is of paramount importance that effective internal controls as well as mechanisms for verifying their effectiveness are in place. The Advisory Committee is concerned by the response of WFP Management, which does not appear to be commensurate with the issues raised. In the opinion of the Committee, the weaknesses pointed out by the Inspector General cannot be addressed simply by updating manuals.

28. The Advisory Committee recommends that the Executive Board request the Executive Director to carry out an assessment of the procurement organizational structure, the processes and internal controls in place and the risks to the Organisation which currently exist. The Executive Director should be requested to make proposals for corrective measures required to strengthen internal controls and to report on the actions undertaken in this regard at the next session of the Board.

