**Executive Board
Third Regular Session**

Rome, 20–24 October 2003

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

For consideration

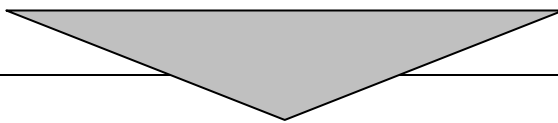# BEST PRACTICES IN OVERSIGHT MECHANISMS

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Note to the Executive Board

This document is submitted for consideration to the Executive Board.

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

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Director, Office of Internal Audit (OEDA):	Mr D. Nelson	tel.: 066513-2045

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

Executive Summary

As requested by the Executive Board at its Third Regular Session in October 2002 (decision 2002/EB.3/10), this paper presents the best practices in oversight mechanisms, in the public and private sectors and in the United Nations system, and current practices at WFP.

Preparation for this paper involved desk-based research, i.e., the use of a questionnaire and reviews of available reports from throughout the United Nations system. It focused on the broader issues of corporate governance in four main areas: codes of conduct, reporting, internal oversight committees and risk management.

The Office of Oversight Services will need to examine further the main themes arising from this review of best practices. It plans to focus on the possible avenues for improvement with a view to enhancing current practices at WFP.

Draft Decision[*]

The Executive Board considers the information provided in document WFP/EB.3/2003/5-D/1 on oversight mechanisms. It takes note of the possible directions for strengthening the Programme's internal oversight and requests the Executive Director to take its views into account in his consideration of the matter.

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[*] This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

INTRODUCTION

1.   When reviewing the biennial report of the Office of the Inspector-General for 2000–2001 at its Third Regular Session in October 2002, the Executive Board decided to discuss further the issue of internal oversight mechanisms, and requested the Secretariat to submit a paper outlining best practices in that area.

2.   The purpose of this paper is to provide information to the Board on best practices in oversight mechanisms in the public and private sectors and at other United Nations bodies, and current practices at WFP.

3.   The issue of best practice in oversight cannot be divorced from the broader issues of corporate governance and risk management. Indeed, it is on these areas that much attention was focused following the scandals that took place in the international corporate sector in 2001 and 2002. Thus, rather than considering oversight mechanisms in isolation, this paper also covers the broader issues of governance and risk management, and the reporting thereof. In this context it should be noted that the requirements currently imposed on United Nations entities are not as rigorous as those imposed on large corporate or public-sector bodies in many countries.

4.   Preparation for this paper involved desk-based research on corporate governance and risk practices in public- and private-sector bodies in various regions of the world. The oversight arrangements in place at several comparable United Nations bodies were examined through the use of a questionnaire and a review of reports from many organizations throughout the United Nations system, including those released by the Joint Inspection Unit (JIU).

Structure of the Paper

5.   This review focuses on four main areas: codes of conduct, reporting, internal oversight committees and risk management. It presents an analysis of possible directions for WFP's Executive Director to consider in each of these areas. The detailed "Research Paper on Oversight, Risk Management and Governance Best Practice" is available upon request.

CODES OF CONDUCT

6.   The best practice among public- and private-sector organizations entails having in place documented codes of conduct applicable to board members and staff. United Nations agencies typically do not have such codes of conduct. However, there do exist a number of initiatives by United Nations and international organizations to adopt conventions for ratification by their member states prescribing measures relating to conduct, such as the Organization for Economic Cooperation and Development (OECD)[1] and United Nations conventions on bribery and corruption.[2]

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[1] OECD, Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, November 1997.

[2] A draft United Nations Convention against Corruption is being debated by the ad hoc Committee for the Negotiation of a Convention Against Corruption, and is expected to be signed by the member states before the end of 2003, in Mexico City.

7.   The United Nations agencies have formally adopted a code of conduct applicable to their staff, and WFP has adopted the International Civil Servants' Commission Code of Conduct.

8.   Management at WFP has been focusing its attention on recent initiatives undertaken in the United Nations Secretariat by the Office of Internal Oversight Services (OIOS) to promote organizational integrity.[3] The WFP Executive Director has requested the Office of Oversight Services (OEDO) to liaise closely with OIOS to determine the steps WFP might take to further ensure adherence to the highest standards of corruption control and organizational integrity, based on a zero-tolerance policy.

REPORTING

Reporting in Published Accounts or Financial Statements

9.   Best-practice organizations in the private and public sectors worldwide include in their published financial statements a description of the processes they have put in place to ensure effective governance, risk management and internal control. Some governmental organizations are required to provide a "Statement on Internal Control" (SIC) as part of their annual reporting. A review of a number of recent biennial reports revealed that no United Nations entity currently provided such a statement.[4]

10.   WFP provides financial statements to its Executive Board on a biennial basis. There is currently no requirement that the Programme include in those financial statements a report on the adequacy of its internal control and risk management or a description of the processes in place to ensure that controls are operating effectively. There is also no requirement that the Executive Director submit to the Executive Board a separate statement on internal control.

Reporting on Internal Oversight Activities

11.   In the private sector, there is no requirement (that WFP is aware of) that the head of a company's oversight or internal audit service prepare an annual report containing opinions on the adequacy of internal control, risk management and governance. Rather, the heads of private-sector internal oversight services, especially those who provide an outsourced internal audit service, issue an annual report to the oversight or audit committee summarizing the results of the audits or oversight activities performed during the year and highlighting significant issues.

12.   In the public sector, internal reporting on the adequacy of internal control, corporate governance and risk management is generally performed at two levels: the head of the oversight or internal audit service submits a report to the oversight or audit committee, and/or the oversight or audit committee submits a report to the chief executive.

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[3] OIOS Organizational Integrity Initiative, launched in May 2003, and focused on internal governance and professional ethics.

[4] However, the climate is already changing. For example, one United Nations agency's external auditors recommended that the "… Director-General may wish, in future financial reports, to include statements concerning her responsibility for preparing financial statements, accepting the responsibility for maintaining a system of internal control, as well as a statement on the effectiveness of this system and on whether or not standards or codes of corporate governance have been adopted."

13.   Reporting on internal oversight activities among United Nations agencies is generally limited to an annual summary or performance review of the oversight or internal audit activities that took place during the year. Such reports are generally provided to the governing body or to a finance committee.

14.   WFP's Office of the Inspector-General submits to the WFP Executive Board a biennial report on inspection and investigation activity.[5] WFP's Office of Internal Audit (OEDA) provides quarterly reports to the Audit Committee, which is accountable to the Executive Director. OEDA does not provide the Audit Committee with an annual report on the internal audit function. The Executive Director includes in his annual report a section on the activities of the oversight services, which is then submitted to the FAO Council and the Economic and Social Council (ECOSOC) in the form of the Executive Board's report.

15.   As in the case of all other United Nations agencies, at WFP the head of oversight is not required to produce a report, either for the Executive Director or for the WFP Audit Committee, expressing opinions on the adequacy of internal control, corporate governance and risk-management systems.

INTERNAL OVERSIGHT[6] COMMITTEES

Private Sector

16.   The creation of audit committees is standard best practice in the private sector.[7] In principle, audit committees are set up on a permanent basis, provide reports and advice to boards, are to varying degrees independent of executive management, possess the requisite expertise, and are financially literate. Audit committees with these attributes are better able to protect the interests of stakeholders. An ideal audit committee would limit its members' tenure and ensure their orderly succession. It would have clear terms of reference that were subject to periodic review to ensure their relevance to the corporation's activities. Meetings of such a committee would take place at least three times annually; meetings independent of management would be held with internal and external auditors. Training would be provided to committee members on the roles of internal and external auditors, on risk management and on corporate governance.

Public Sector

17.   Oversight or audit committees are strongly recommended as best practice in many public-sector bodies throughout the world. The Institute of Internal Auditors recommends that "every organization, irrespective of its size and nature, should have an audit committee, or an appropriate equivalent." Public-sector organizations with a board structure that is separate from executive management generally have audit committees that are sub-committees of their boards.

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[5] General Regulations, Article VI.2 (b) (viii).

[6] "Oversight committee" is intended as covering both internal audit and inspection and investigation activities, in the sense most commonly used within the United Nations system. In the private and public sectors, the term most commonly used is "audit committee".

[7] Recent legislation (e.g., the Sarbanes-Oxley Act of 2002 in the United States of America) requires public companies to establish an audit committee.

18.   Best-practice public-sector organizations provide regular training to their oversight or audit committee members. The training normally covers the role of the committee, risk management, corporate governance, and technical updates, such as accounting and legislative changes. Such training can include briefings by members of the executive management team on significant changes in internal-control structures or accounting policies.

United Nations System

19.   The use of internal oversight or audit committees at United Nations agencies is varied. Many agencies have a finance committee or equivalent that is made up of representatives of member states. Two United Nations agencies have audit committees that are sub-committees of their executive boards, and consist of a smaller number of member state representatives. In terms of control and governance, these committees are usually responsible for considering, *inter alia,* the biennial accounts and reports from the external auditor. They may also consider some form of annual activity report from the internal audit service. In some agencies, including WFP, such matters are considered by the full governing body.

20.   Some agencies have, in addition to a finance committee or equivalent, a specific internal oversight or audit committee. These committees are, in effect, internal committees whose membership comprises some senior members of agency staff and, in some cases, external experts. Such committees do not, however, include among their membership nominees from the agency's governing body. Thus, they are executive committees with no representation from what might be termed non-executives (e.g., representatives from member states).

21.   The case of one United Nations agency provides a good example of this model. Its oversight committee is chaired by the Deputy Director-General, and the other members are two internal senior managers and two external members with experience in audit and evaluation. Membership on this oversight committee is permanent for internal members, as long as they hold their management position; external members are appointed for a two-year term, which can be renewed for an additional two years.

22.   Another United Nations agency's audit committee consists entirely of senior executive managers, and has no external members (as is the case with WFP's audit committee). Regional directors are appointed to the committee on a rotating basis for one-year periods; other members are appointed for as long as they hold their positions in the agency.

23.   The audit committees at the above-mentioned United Nations agencies have documented terms of reference that have been approved by their executive boards. The committees meet on a quarterly basis.

24.   The first agency's oversight committee does not provide its executive board with an annual report on the effectiveness of internal controls and governance. However, the director of internal oversight services of the agency provides an annual report to the agency's executive director. That report is made available to the agency's executive board. In the agency's 2001 annual report, the head of oversight provided an overall conclusion as to the adequacy of internal control systems.

25.   The second agency's audit committee endorses the annual oversight report, which is prepared for the agency's executive board.

⇨ **WFP**

26.   In the case of WFP, the Executive Director has appointed an Audit Committee. The committee is chaired by the Deputy Executive Director, Operations, and comprises four senior executive managers. The committee meets quarterly and provides oral reports to the Executive Director. The committee does not provide reports to the Executive Board.

27.   The terms of reference for the WFP Audit Committee are documented in the Executive Director's circular dated 13 July 2000.

28.   The main responsibilities of the WFP Audit Committee include:

  ➢ ensuring the independent role of WFP's internal audit function;

  ➢ appraising the adequacy of the audit plans and the scope and general effectiveness of internal audit services;

  ➢ reviewing the reports of the internal and external auditors and monitoring implementation of their audit recommendations; and

  ➢ ensuring that internal audits undertaken at WFP are conducted in accordance with internationally accepted auditing standards, including those prescribed by the panel of external auditors of the United Nations (including specialized agencies and the International Atomic Energy Agency) and the internal auditors of the United Nations system.

29.   While the function of WFP's Audit Committee essentially mirrors that of other public- and private-sector organizations, its members are WFP's executive managers, whose areas of responsibility may themselves be subject to internal audit or oversight review. Clearly, this may call into question the audit committee members' independence and give rise to possible conflict of interest. (However, the same can be said of most other United Nations agencies.) Therefore, WFP may need to consider ways of mitigating this.

RISK MANAGEMENT

Private and Public Sector

30.   Even prior to the recent corporate scandals, large private-sector companies were increasingly focusing on risk management. Risks relating to all aspects of an entity's operations, not only financial control, are identified by management. Typically, company management will assess the likelihood of the risk's maturing and the impact that would have on business operations.

31.   Therefore, as is also the case in the best managed public-sector bodies, "best of class" private-sector companies generally have in place both a risk-management policy and a risk strategy that:

  ➢ identify the key risks that may affect the achievement of their corporate objectives;

  ➢ assess the likelihood that the events to which the risks relate will actually happen;

  ➢ assess the impact of the risks on the business in both financial and non-financial terms, taking into account mitigating actions or controls; and

  ➢ put in place strategies and policies to monitor and manage the risks, and mechanisms to promptly identify any new risks that arise.

32. In the above context, attention is focused primarily on identifying and then managing or reducing those risks that would affect profits or have implications for cost.

33. In order to ensure that sufficient attention is devoted to this area, many companies will regularly review, at the Board level, all the key risks they are facing. Their Boards may also assess the adequacy of the planned or implemented mitigation measures; in many cases, the oversight or audit committee plays an active role in this area.

34. At a lower level, many larger companies appoint dedicated full-time risk managers to oversee the risk management process. In some companies, the responsibility for assessing and monitoring the adequacy of risk management is devolved to internal audit.[8]

35. As a matter of best practice, public-sector bodies are required to have in place risk-management, control and review processes. An organization's control environment is then developed from the risk-management process (i.e., the identification and mitigation of risks and the identification and exploitation of opportunities). Risk management is a key component of good governance.

United Nations System

36. In the United Nations system, few if any entities have in place risk-management policies or processes. However, one United Nations agency, while not having a formal risk-management policy, does have in place equivalent procedures and processes to manage risks across the agency. This activity is spearheaded by the agency's internal oversight unit. To form part of the agency's risk-management function, a comprehensive and systematic process to identify risks has been put in place. Also in place is a process to analyse and prioritize each identified risk. The risks are recorded in a risk register, and the management of each risk is linked to the internal audit plan. This process is supported by regular and ongoing risk review.

⇨ *WFP*

37. At WFP, a risk-assessment exercise is performed at a lower level by OEDA. However, rather than being a formal risk assessment for risk-management purposes, this process is currently aimed at ranking country offices in terms of risk and determining the internal audit plan. OEDA plans to broaden its risk-assessment exercise, using Control Risk Self-Assessment (CRSA) techniques; this will include Headquarters divisions and units.

38. There is currently a significant gap between WFP and best-practice public- and private-sector organizations in relation to risk management arrangements. In order to rectify this, WFP management will need to focus on:

➢ establishing an enterprise-wide strategy for coordinating risk management, thus strengthening the manner in which executive management manages risk as part of their day-to-day activities; and

➢ granting, at a strategic level, responsibility for risk management (e.g., to a risk-management committee or risk manager), implementing a risk-identification process, and linking identified risks with WFP's corporate objectives.

[8] Internal oversight play an important facilitation role in the initial stages of developing and implementing risk-management policies and strategies, as these are eventually mainstreamed into the standard operating procedures under the responsibility of management.

AREAS FOR FURTHER REVIEW

39. OEDO will need to review the main themes arising from this review of best practices and take steps to improve or alter WFP's oversight mechanisms. OEDO would focus its attention on the following possible directions, for consideration by the Executive Director:

➢ **Code of conduct:** OEDO would identify possible steps for improving organizational integrity, in liaison with the United Nations OIOS initiative in that area.

➢ **External and internal reporting:** There is a significant opportunity for WFP to become a United Nations system leader in reporting on governance arrangements, and adopting improved reporting on internal oversight activities to the Executive Board. This could include presenting in the financial statements a statement on internal controls issued by management, and submission to the Board of an expanded report by the Director of OEDO on internal audit, inspection and investigation activities and issues.

➢ **Internal oversight committee:** WFP could review the opportunity for establishing, in place of the existing Audit Committee, an Internal Oversight Committee, reporting to the Executive Director. The committee would cover internal audit, inspection and investigation activities, and risk-management, internal control and corporate governance issues.

➢ **Risk management:** There is a need to take the lead and assist management in initiating and implementing a risk-management policy and related strategy.

ACRONYMS USED IN THE DOCUMENT

CRSA	Control Risk Self-Assessment
ECOSOC	Economic and Social Council
JIU	Joint Inspection Unit
OECD	Organization for Economic Cooperation and Development
OEDA	Office of Internal Audit
OEDO	Office of Oversight Services
OIOS	Office of Internal Oversight Services
SIC	Statement on Internal Control