

RATIONALE FOR A REVIEW OF THE STRUCTURE OF THE AUDIT COMMITTEE



INFORMAL CONSULTATION ON WFP AUDIT COMMITTEE

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World Food Programme
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I. BACKGROUND

1. This paper provides an overview of recent developments in governance and oversight, focusing on best practice and the role of audit committees.
2. The paper is a first submission in response to the request made by the Bureau at its meetings on 10 and 17 May 2006 for material exploring possible changes in the composition and reporting lines of the WFP Audit Committee. In these discussions, the question was raised whether the Audit Committee should be appointed by and report to the Executive Board rather than to the Executive Director, as is currently the case.
3. The Bureau endorsed proceeding with this review at the informal consultation on 9 October 2006. As appropriate, a final proposal incorporating recommendations from the informal consultation will be submitted to the Board at EB.2/2006 or thereafter.

II. RECENT DEVELOPMENTS IN GOVERNANCE AND OVERSIGHT

4. Recent oversight failures in the private sector – at Enron and WorldCom for example – and in the public sector – the United Nations oil-for-food programme, which was examined in the Volcker report – have led to significantly greater scrutiny of governance structures worldwide. The United States has introduced comprehensive principles, official guidelines and legislation governing the private sector under the Sarbanes-Oxley Act (2002) and related Securities Exchange Commission (SEC) guidance. In other countries there has been less legislative action but an increased focus on self-regulation through requirements to “comply or explain” with respect to recommended principles or guidelines for corporate governance; the United Kingdom’s Combined Code on Corporate Governance (2003) is an example.
5. In the United Nations this topic was discussed in the 2005 World Summit Outcome (resolution 60/1), where the General Assembly requested the Secretary-General to take action to strengthen governance and oversight in the United Nations system. In response, the Secretary-General commissioned a highly experienced steering committee to conduct a review and recommend improvements in several areas of governance and oversight in the United Nations. The results of this review were published in the *Comprehensive Review of Governance and Oversight within the United Nations and its Funds, Programmes and Specialized Agencies* submitted to the Secretary-General on 10 July 2006.

III. ROLE OF AUDIT COMMITTEES

6. Audit committees are rapidly becoming integral to governance structures. Over the last three years, audit committees reporting to executive boards have become either mandatory or recommended best practice in 41 countries. In the private sector, the prominence of Audit Committees is well illustrated by the fact that the executive boards of all S&P 500 companies' now have an Audit committee reporting to them.
7. Audit committees have evolved from optional committees with few specified responsibilities and are today the expected norm with responsibilities to oversee the financial reporting, risk management and internal control of an organization on behalf of its executive board.
8. Audit committees typically consist of between three members, the minimum requirement in most countries, and five members, who are appointed by the executive board. The most important developments in audit committees over the last few years have been ensuring that they are independent and that the members have appropriate skills. Emerging best practice for membership criteria can be found in the private sector, as illustrated by S&P 500 companies:
 - All S&P 500 boards have an audit committee comprised entirely of members who are independent from management and the board.
 - All audit committees have at least one designated financial expert – this is mandatory in most countries; 21 percent have two such experts; 28 percent have three or more.
 - Audit committee members have acquired their expertise from a variety of backgrounds: 45 percent of audit committee members are active or retired Chairmen, Presidents or CEOs; academics, active or retired CFOs and professional auditors are also represented.

IV. RECENT DEVELOPMENTS IN AUDIT COMMITTEE MATTERS IN UNITED NATIONS SYSTEM

9. The United Nations system has been moving towards establishing independent audit committees reporting to the Governing Bodies in line with accepted best practice. The developments in the United Nations have been largely driven by the recommendations in the *Comprehensive Review of Governance and Oversight within the United Nations and its Funds, Programmes and Specialized Agencies* and the decision of The United Nations General Assembly to establish the Independent Audit Advisory Committee (IAAC) in accordance with these recommendations.

10. The United Nations Educational, Scientific and Cultural Organization (UNESCO) is the first United Nations agency to establish an audit committee in line with recognized best practice in terms of composition and reporting responsibilities. Established in June 2006, it is called the Oversight Committee, reporting to the Executive Board and the Director-General of UNESCO. It consists of five members who are external to the Secretariat and Executive Board of UNESCO and who have recent experience in financial management, risk and oversight. The terms of reference of the Oversight Committee are currently being created; they will be reviewed by the Executive Board at its first meeting in 2007. The Oversight committee will have an advisory role, focusing on matters concerning external risks, organizational concerns and financial reporting that may arise in reviews by the internal and external auditors or otherwise brought to the attention of the Oversight Committee.
11. Other United Nations agencies are also in the process of establishing audit committees in line with accepted best practice. A proposal for establishing an independent audit committee reporting to the board will be considered at the January board meeting of the United Nations Development Programme (UNDP). The United Nations Children's Fund (UNICEF), the Office of the United Nations High Commissioner for Refugees (UNHCR) and the International Civil Aviation Organization (ICAO) have developed action plans for establishing audit committees in line with recommended best practice.

V. IMPLICATIONS FOR WFP

12. WFP believes that its governance should meet the highest standards of United Nations agencies and comparable public-sector organizations and has consistently been in the forefront of governance and oversight developments in the United Nations system. This has included upgrading the role and prominence of its Audit Committee, for which a new structure was introduced at EB.3/2003, EB.1/2004 and EB.3/2004 that has hitherto been regarded as best practice in the United Nations system. In this structure, the independence of WFP's Audit Committee was enhanced by the appointment of an external oversight expert as the chairperson and by ensuring that a majority of its members are external to WFP. The Audit Committee is, however, still not independent of management: it reports directly to the Executive Director, and management is represented by two members.
13. It would be very helpful to have the advice of the Membership on establishing an Audit Committee in line with acknowledged best practice with respect to its composition and reporting lines.

SOURCES

This paper was prepared on the basis of an extensive review of the relevant literature. Numerous industry reports were studied, including:

- United Kingdom Financial Reporting Council. Committee chaired by Sir Robert Smith. 2003. *Audit Committees - Combined Code Guidance*.
- PricewaterhouseCoopers and The IIA Research Foundation. 2006. *Audit Committee Effectiveness – What Works Best*, 3rd edition.
- KPMG, Audit Committee Institute. 2006. *International survey of Audit Committee Members*.
- Spencer Stuart. 2005. *Spencer Stuart Board Index 2005*.
- KPMG, Financier Worldwide. 2006. *The Evolving Role of the Audit Committee*.
- PriceWaterhouseCoopers. 2003. *Audit Committees: Good Practice for Meeting Market Expectations*, 2nd edition.
- United Nations General Assembly, 60th session, agenda items 46 and 120, 10 July 2006. *Comprehensive Review of Governance and Oversight within the United Nations and its Funds, Programmes and Specialized Agencies*.

INTERVIEWS

The UNESCO example is based on interviews with:

- **John Fox** – Chairman of the UNESCO Oversight Committee; previously a Joint Inspection Unit Inspector for six years and a member of the Advisory Committee on Administrative and Budgetary Questions (ACABQ).
- **John Parsons** – Director of Internal Oversight Services at UNESCO and a member of the current WFP Audit Committee.