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Organisation des Nations Unies pour l'alimentation et l'agriculture

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REPORT OF THE EXTERNAL AUDITOR
ON THE FINANCIAL OPERATIONS OF
THE FOOD AND AGRICULTURE ORGANIZATION
OF THE UNITED NATIONS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016

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EXECUTIVE SUMMARY

Introduction

1. This Report of the External Auditor on the audit of the financial operations of the **Food and Agriculture Organization** (FAO) of the United Nations (UN) is issued pursuant to Regulation XII and the Additional Terms of Reference of the Financial Regulations of FAO. It contains the results of the audit on the financial statements for the financial year ending 31 December 2016 and the observations with respect to the administration and management of the Organization as required under Regulation 12.4.

2. This is the third report issued on an annual basis since the adoption by FAO of the International Public Sector Accounting Standards (IPSAS) as its financial reporting framework effective financial year 2014. The general objectives of the audit are to provide independent assurance on the fairness of presentation of the financial statements to Member States, to help increase transparency and accountability in the Organization, and to support the objectives of the Organization's work through the external audit process. The Report discusses in detail the financial and governance matters that the External Auditor believes should be brought to the attention of the FAO Governing Bodies.

Overall result of the audit

3. In line with our mandate, we audited the financial statements of FAO in compliance with the Financial Regulations and in conformity with the International Standards on Auditing (ISA).

4. Our audit resulted in the issuance of an unmodified audit opinion[1] on the Organization's financial statements for the financial year ended 31 December 2016. We concluded that the financial statements present fairly, in all material respects: (a) the financial position of FAO for the year ended 31 December 2016; (b) its financial performance; (c) the changes in net assets/equity, (d) its cash flows; and (e) the comparison of budget and actual amounts of its expenditures for the said year in accordance with IPSAS.

5. We also concluded that the accounting policies were applied on a basis consistent with that of the preceding year, and the transactions of FAO that have come to our notice during the audit or have been tested as part of the audit of the financial statements are, in all significant respects, in compliance with the Financial Regulations and legislative authority.

6. In line with Regulation 12.4, we conducted performance audit work in addition to financial audit. Our performance audit work is aligned with FAO risks. It included the review of: (a) preparedness to issue a Statement on Internal Control; (b) management controls in key business processes; (b) managing controls in projects; and (c) managing risks. We provided Management with recommendations that are designed to support the objectives of FAO's work, to reinforce its accountability and transparency, and to improve and add value to FAO's financial management and governance.

[1] Unmodified audit opinion – Under ISA 700, this is an opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. This is the new terminology that replaced "unqualified or clean opinion".

7. Under financial matters these recommendations included the need to address the funding gap on employee benefit obligations, improve the procedures on accrual of expenses on investments, and enhance the reporting capabilities of the Travel Module in the GRMS.

8. Under governance matters, we identified areas for improvement in the preparedness to issue a Statement on Internal Control and the need to address control weaknesses in the management of procurement, letters of agreement, human resource, cash, assets and inventory, and staff travels.

9. Under how FAO manages projects, we made recommendations on the usability, complexity and training adequacy on the use of FAO systems and actions to improve the promptness, level, and adequacy of information of project delivery.

10. On how the Organization handles risks including fraud susceptibilities, we made recommendations in the areas of addressing the challenges in embedding risk management and the need for dynamism and updating of control plans in decentralized offices.

Summary of recommendations

11. We made several value-adding recommendations designed to support the objectives of FAO's work, to reinforce accountability and transparency, and to improve and add value to FAO's financial management and governance. The main recommendations are that the Organization:

Recommendations		Priority	Timeline
Financial Matters			
Funding of employee benefit obligations			
1	**Evaluate in greater detail the best option to address its remaining unfunded staff-related liabilities with the goal of identifying a consistent funding source and come up with a comprehensive plan to fully fund the SRL over a determined period of time. (*Paragraph 37*)**	**Fundamental**[2]	**2017**
Accrual of expenses on Investments			
2	**Ensure that investment management fees are recorded in the period they were incurred as required under IPSAS by utilizing the invoices and approved Request for Payment provided by the Custodian as primary reference and ensure that the closure instructions in succeeding financial periods consider the proper accounting treatment of management fees. (*Paragraph 42*)**	**Significant**[3]	**2017**

[2] **Fundamental:** Action is considered imperative to ensure that the Organization is not exposed to high risks. Failure to take action could result in serious financial consequences and major operational disruptions.

[3] **Significant:** Action is considered necessary to avoid exposure to significant risks. Failure to take action could result in financial consequences and operational disruptions.

	Recommendations	Priority	Timeline
Global Resource Management System (GRMS)			
3	**Enhance the reporting capabilities of the Travel Module by considering user needs and using the most appropriate format to maximize the use of information. The ongoing efforts to review the reporting capability of iMIS must be pursued, to ensure inclusion of the travel monitoring report at the level of the initiator to facilitate compliance with policies on travel and eliminate duplication of manual reports in the field offices. (*Paragraph 46*)**	**Significant**	**2017**
Governance Matters			
Preparedness to issue a Statement on Internal Control (SIC)			
4	**Ensure that its risk management practices effectively integrate with and support its Internal Control Framework (ICF) through an assessment of its current risk management practices prior to the initial issuance of the SIC to identify areas for enhancement that will guarantee a more efficient and effective design of risk controls and for clearer accountabilities. (*Paragraph 53*)**	**Fundamental**	**2017**
5	**Ensure that the internal control awareness across the Organization is elevated to a level that is aligned to the adopted internal control principles through effective competency building strategies before the SIC is issued to increase the level of assurance to be provided by the related internal control disclosures. (*Paragraph 60*)**	**Fundamental**	**2017**
Managing controls in key business processes			
6	**Optimize the performance of its management controls around critical operational processes through more robust monitoring and supervision of the performance of these controls and ensure that key controls in every critical process are closely monitored to improve process performance, accountability and management decisions. (*Paragraph 83)***	**Significant**	**2017**
Managing controls in projects			
Field Project Management Information System (FPMIS)			
7	**Revisit/update the Navigation Improvement Recommendations to make the System user-friendly so that this will become acceptable to the**	**Significant**	**2017**

	Recommendations	Priority	Timeline
	intended users, thus, advancing the level of usability of functionalities. *(Paragraph 91.a)*		
8	**Capture the delays in the submission of final financial reports to donors under the existing Field Programme Support Network (FPSN) quarterly monitoring facility in coordination with CSF, given that the final financial report comes chronologically after financial closure, and consider the uploading of the duly received covering letter of financial reports by the donor for better compliance with donor reporting. *(Paragraph 91.b)***	**Significant**	**2017**
9	**Improve the functionalities in the Logical Framework Matrix (LFM), work plan monitoring and budgeting to make it more flexible and adaptable to project requirements, and to include indicators to monitor qualitative aspects of project implementation. *(Paragraph 91.c)***	**Significant**	**2017**
10	**Conduct a comprehensive analysis of the crucial issues identified by system users to obtain better clarity in defining its roadmap to deliver an integrated solution and in prioritizing its activities, moving forward. (*Paragraph 92*)**	**Significant**	**2017**
11	**Step up its process and integration enhancements of related systems, particularly focusing on the following:** **a) inclusion of sub-lines segment in the GRMS to ensure that project expenditures can be easily and systematically monitored and reported by results and taking into consideration the effects of budget equalization;** **b) restoration of the asset link with GRMS to enable the availability of the list of equipment in the FPMIS;** **c) provision of link between financial data in FPMIS with GRMS for generation of information in real-time, and inclusion in the single log-in access of *i*MIS as this is the access design for all interrelated systems; and** **d) inclusion of budget fungibility segments in GRMS in support of the existing module in**	**Significant**	**2017**

	Recommendations	Priority	Timeline
	FPMIS for effective monitoring of projects at the point of commitment and expenditures. ***(Paragraph 97)***		
12	**Intensify the training of FPMIS users with broader participation based on all roles in project management, and consider other capacity building mechanism that will benefit system users on an organization-wide basis.** ***(Paragraph 102)***	**Significant**	**2017**
Technical Cooperation Programme (TCP)			
13	**Ensure the overall efficiency and effectiveness of TCP projects through mechanisms that exact responsibilities and properly manage events or instances affecting the promptness, level, and adequacy of information on TCP commitment delivery.** ***(Paragraph 107)***	**Significant**	**2017**
Projects funded by voluntary contributions			
14	**Ensure that voluntary funded projects are carried out through activity and monitoring controls that bolster adequate identification and proper management of factors and delivery of project accountabilities that affect the overall efficiency and effectiveness of project implementation.** ***(Paragraph 112)***	**Significant**	**2017**
15	**Consider incorporating a specific provision in all funding agreements it enters into with its resource partners on the disposition of unspent balances, together with the options for the proposed use of the remaining funds in case donors will not respond to requests for refund instructions within a specific period.** ***(Paragraph 116)***	**Significant**	**2017**
Reporting to donors			
16	**Ensure the delivery of its donor reporting accountability through sustained efforts of monitoring activities and controls that exact and backstop delivery of project responsibilities of process owners, and assure that systems provide timely, reliable and relevant information.** ***(Paragraph 120)***	**Significant**	**2017**

	Recommendations	Priority	Timeline
Managing risks			
Risk management			
17	**Revisit its risk management framework and the process by which it is being adopted, craft strategies to embed this across all levels of the Organization, and ensure that its adaptive capacity is fully considered and that the shared concept of risk management is embraced by all stakeholders to achieve the intended benefits of risk management.** ***(Paragraph 125)***	**Significant**	**2017**
Fraud risk response mechanisms			
18	**Ensure that its fraud vulnerabilities are properly managed through mechanisms that champion dynamic and up-to-date FCPs replete with measures which increase the perception of detection, reinforce segregation of incompatible functions, ensure safeguarding of resources and affirm compliance with regulations.** ***(Paragraph 128)***	**Fundamental**	**2017**
Cases of Fraud and Presumptive Fraud			
19	**Continue to strengthen its fraud risk governance through processes and mechanisms that afford adequate fraud risks identification and definition of responses for better management of its fraud exposures.** ***(Paragraph 138)***	**Fundamental**	**2017**

Implementation of prior years' audit recommendations

12. The status of implementation by Management of previous audit recommendations of the External Auditor is embodied in a separate report presented to the Finance Committee. Of the 21 recommendations in the Financial Year 2015, 11 (52 per cent) were implemented and 10 (48 per cent) are in the process of implementation. Thirteen (50 per cent) out of 26 recommendations in the Financial Year 2014 were implemented while the remaining 13 (50 per cent) were in the process of implementation. Of the 57 recommendations made for the Biennium 2012-2013, Management had already implemented 55 recommendations (96 per cent), leaving two recommendations (4 per cent) still in the process of implementation. We encourage Management to prioritize the implementation of the remaining recommendations.

A. MANDATE, SCOPE AND METHODOLOGY

Mandate

13. The Commission on Audit of the Republic of the Philippines was appointed by the 146th Session of the Council[4] as External Auditor of the Organization for a period of six years commencing with the year 2014.

14. As the External Auditor, we are mandated to issue a report on the audit of the financial statements for each calendar year, which shall include information necessary in regard to matters referred to in Financial Regulation 12.4 and in the Additional Terms of Reference. The report together with the audited financial statements, is transmitted to the Council through the Finance Committee (FC), with any directions given by it. The Council shall examine the financial statements and audit reports and shall forward them to the Conference with such comments as it deems prudent.

15. This is the third year of our new audit mandate and the third Report of the External Auditor to be issued on an annual basis since the adoption of IPSAS as the financial reporting framework of the Organization starting 2014.

Scope and objectives

16. Our audit is an independent examination of the evidence supporting the amounts and disclosures in the financial statements. It includes the assessment of the accounting principles used and significant estimates made by the Organization, and the overall presentation of the financial statements. It also includes an assessment of FAO's compliance with Financial Regulations and legislative authority.

17. The primary objectives of the audit are to provide an independent opinion on whether:

a. the financial statements present fairly the financial position of FAO as at 31 December 2016, the results of its financial performance, the changes in its net assets/equity, the cash flows of the Organization and the comparison of its budget with actual amounts of expenditures for the financial year ended 31 December 2016 in accordance with IPSAS;

b. the accounting policies set out in Note 2 to the financial statements were applied on a basis consistent with that of the preceding financial period; and

c. the transactions that have come to our notice or that we have tested as part of the audit, comply in all significant respects with the Financial Regulations and legislative authority.

18. The External Auditor likewise conducted a review of the Organization's operations pursuant to Financial Regulation 12.4 to make observations with respect to the efficiency of the financial procedures, the accounting system, the internal financial controls, and in general, the administration and management of its operations. Those matters are addressed in the relevant sections of this Report.

[4] Resolution 1/146 adopted on 26 April 2013

19. Overall, the audit intends to provide independent assurance to Member States, to reinforce transparency and accountability in the Organization, and to support the objectives of the Organization's work through the external audit process.

Methodology and auditor's responsibilities

20. We conducted our audit in accordance with the ISA. These standards require that we plan and perform an audit to obtain reasonable assurance that the financial statements are free from material misstatements. The audit includes examining evidence supporting the amounts and the disclosures in the financial statements on a test basis. The audit also includes assessing the accounting principles used and the significant estimates made by Management as well as evaluating the overall presentation of the financial statements. We adopted the Risk-based Audit Approach in the audit of the financial statements which requires us to conduct risk assessment to identify all possible material misstatements in the financial statements and the assertions accompanying it, based on an understanding of the entity and its environment.

21. The External Auditor's responsibility is to express an opinion on the financial statements based on an audit. An audit is performed to obtain reasonable assurance, not absolute assurance, as to whether the financial statements are free from material misstatements caused by either fraud or error.

22. We also reviewed the effectiveness of management controls in key areas of operations, risk management, operations of selected decentralized offices with a focus on the technical cooperation programme, project implementation, the country programming framework and the fraud risk response mechanism, in line with Financial Regulation 12.4.

23. For the financial year 2016, we conducted audits in: the Headquarters (HQ) that included the Agriculture and Consumer Protection Department (AG); in two regional offices, namely, the FAO Regional Office for Asia and the Pacific (FAORAP), and FAO Regional Office for Latin America and the Caribbean (FAORLC); and in eight representation offices, namely, the FAO Representation Offices in Indonesia (FAINS), Myanmar (FAMYA), Sudan (FAOSD), Pakistan (FAOPK), Argentina (FLARG), Ethiopia (FRETH), Kenya (FRKEN), and Somalia (FRSOM).

24. We also audited the financial statements of the FAO Credit Union and the FAO Staff Commissary for financial year 2016 and we issued separate reports on each. Further, we reviewed and certified the Status of Funds of the programmes implemented in cooperation with or on behalf of other agencies, namely the United Nations Development Programme (UNDP) and the Global Environment Facility (GEF).

25. We coordinated planned audit areas with the Office of the Inspector General (OIG) to avoid unnecessary duplication of efforts, and determine the extent of reliance that can be placed on the latter's work. We also collaborated with the Audit Committee to further enhance our audit work.

26. We reported the audit results to FAO Management in the form of management letters containing detailed observations and recommendations. This practice provides a continuing dialogue with Management.

B. RESULTS OF AUDIT

27. This section presents the results of the audit for the financial year 2016. It covers matters that in the opinion of the External Auditor, should be brought to the attention of the Governing Bodies. We afforded FAO Management the opportunity to comment on our audit observations to ensure balanced reporting and to co-develop solutions. The recommendations provided to Management are designed to support the objectives of FAO's mandate, to reinforce its accountability and transparency to improve and add value to FAO's financial management and governance.

B.1 FINANCIAL MATTERS

B.1.1 Audit of financial statements

Opinion on the financial statements

28. We issued an unmodified opinion on the FAO's financial statements. We concluded that the financial statements present fairly, in all material respects, the financial position of the FAO for the financial year ended 31 December 2016, the results of its financial performance, the changes in net assets/equity, the cash flows, and the comparison of budget and actual amounts of its expenditures in accordance with IPSAS.

Application of accounting policies and test of transactions

29. As required by FAO Financial Regulations, we concluded that the accounting policies were applied on a basis consistent with that of the preceding year. We likewise concluded that the transactions of FAO that have come to our notice during the audit or that have been tested as part of the audit of the financial statements are, in all significant respects, in accordance with the Financial Regulations and legislative authority of FAO.

30. We recognize the effort of Management in early adopting IPSAS 39 - Employee Benefits replacing IPSAS 25 of the same title, during the year instead of its effectivity on 1 January 2018. The difference between IPSAS 39 and IPSAS 25 consists of the introduction of the net interest approach and amendment of certain disclosure requirements for defined benefit plans. The change resulted in additional and expanded note disclosures for employee benefit obligations.

31. As a result of our recommendations, Management added descriptions of plan amendments, curtailments and settlements, the re-measurements of the net defined benefit liability (asset), separate presentation of contributions to the plan by the employer and by plan participants, description of any asset-liability matching strategies used by the plan or the entity, including the use of annuities and other techniques and an indication of the effect of the defined benefit plan on the entity's future cash flows.

32. We identified other issues that need to be addressed by Management to further improve the recording, processing and reporting of transactions and ensure the fair presentation of the financial statements in the subsequent reporting periods and these are presented in the Management Letter and in the succeeding paragraphs.

B.1.2 Funding of employee benefit obligations

Need to address funding gap

33. We noted that the total Staff-Related Liabilities (SRL) significantly increased by USD 194.4 million or 17 per cent from USD 1,124.8 million in 2015 to USD 1,319.2 million in 2016, rising back to the level of liabilities in 2014 that stood at USD 1,390.6 million. We also noted that the unfunded After Service Medical Coverage (ASMC) increased by USD 166.5 million in 2016, a 26 per cent increase from the 2015 balance, primarily due to changes in actuarial assumptions such as the decrease in the discount rate used (from 3.3 to 2.7 per cent for ASMC), increase in the medical cost inflation rate and decrease in the year-end EUR-USD exchange rate. On the other hand, investments set aside to back up the non-current employee benefit obligations increased by only 7 per cent or USD 28.8 million, from USD 414.8 million in 2015 to USD 443.6 million in 2016. The consequence was a net increase in the unfunded SRL from 63 per cent (USD 709.9 million) in 2015 to 66 per cent (USD 875.6 million) in 2016.

34. We noted the information presented in document FC 166/5 that a biennium total of USD 45.4 million (USD 22.7 million per year) would need to be contributed in order to fully cover the unfunded ASMC past service liability using a 30-year amortization period beginning 2010. Notwithstanding the increase in the unfunded amount of the ASMC, assessments on Member Nations towards funding of the past service ASMC liability for the biennium 2016-17 as approved by the Conference in June 2015, had remained unchanged at USD 7.05 million per year or USD 14.1 million per biennium. For the Terminal Payment Fund (TPF), FC 166/5 also highlighted that based on the actuarial valuations and in order to fully fund the TPF past service liability of USD 59.9 million using a 15-year amortization period starting in 2010, the Organization would need to contribute an additional USD 6.0 million per year or USD 12.0 million per biennium.

35. We had already brought to the attention of the Organization in our previous reports the extreme urgency to fully fund its staff-related liabilities and observed that Management continues to draw the attention of the Governing Bodies, including presenting regular documents and providing updated information on the size of the liabilities. We noted that options to address the funding gap of the ASMC Liability and on activities aimed at containing the costs of the current medical insurance plan has been an ongoing concern within the United Nations System. We emphasize that further deferment of decisions on funding proposals for the liability can compromise the Organization's ability to meet future related obligations.

36. FAO continues to be financially challenged by issues on the future funding of the SRLs. Despite efforts to put in place a comprehensive strategy to improve the status of its unfunded SRL, the fact remains that the ASMC liability is only 32 per cent funded as at 31 December 2016 and the Conference had not approved any provision for the funding of the TPF in its Programme of Work and Budget (PWB) 2016-17.

37. **We reiterate our prior recommendation that Management evaluate in greater detail the best option to address its remaining unfunded staff related liabilities with the goal of identifying a consistent funding source and a comprehensive plan to fully fund the SRL over a determined period of time.**

38. Management confirmed that it continues to draw the attention of the Governing Bodies to this matter, including presenting regular documents providing updated information on the size of the liabilities, options to address the funding gap of the ASMC Liability, the ongoing

discussions within the United Nations System on this matter and on activities aimed at containing the costs of the current medical insurance plan.

B.1.3 Accrued Expenses on Investments

Need to improve procedures on accrual of expenses on investments

39. FAO's investments are externally managed and assets are held by a Custodian. FAO pays custody and management fees which are offset against the investments. These management fees are reported by the Custodian as FAO's expenses in its Income and Expense Summary Report within the Bid/Ask Reporting submitted by the Custodian to FAO.

40. During the audit, we observed that the Custodian reported management fees as they were paid and not as the expenses were actually incurred and that the Finance Division (CSF) similarly recorded the fees on this same basis.

41. This resulted in an understatement of management fees of USD 0.2 million in 2016 and an overstatement of USD 0.1 million in 2015. As the fees are debited directly against the investments account, it consequently overstated the investments account by USD 0.2 million in 2016 and understated it by USD 0.1 million in 2015.

42. **We recommended that FAO ensure that investment management fees are recorded in the period they were incurred as required under IPSAS by utilizing the invoices and approved Request for Payment provided by the Custodian as primary reference and ensure that the closure instructions in succeeding financial periods consider the proper accounting treatment of management fees.**

43. Management confirmed that a modified process has been implemented to address this recommendation.

B.1.4 Global Resource Management System (GRMS)

Need to enhance reporting capabilities of the Travel Module

44. Our review of GRMS was focused on the validation of the implementation of prior years' recommendations relating to the operationalization of FAO's management framework and process controls enhancements. The review covered the operations and maintenance plan, travel and purchase order (PO) accruals, accounts receivable (AR) interfaces, and asset management. Eight recommendations were reported as implemented and only one as partially implemented. This exception refers to the enhancement of reporting capabilities for the Travel Module and which Management indicated would be implemented by the third quarter of 2017. The reporting capabilities of the Integrated Management Information System (iMIS) will be reviewed to develop frequently used travel reports.

45. In our validation of Management comments on actions taken to address the recommendations, we confirmed that the operations and maintenance documents were endorsed by the Information Technology Division (CIO) and published in the FAO intranet. Likewise, the Entitlement Travel Module was implemented in October 2014 and the Local Travel Module was progressive rolled out in April and May 2017, and will be eventually completed in June 2017. The automated AR interface to general ledger (GL) is ongoing with

daily reports for validation and monitoring. Moreover, CIO has already developed the Travel to GL accrual automation program in support of Month and Year-End Closure facility and travel system enhancements were introduced and made effective in June 2015 incorporating prior recommendations on travel expense claim (TEC), back-to-office report (BTOR) and other travel concerns. Asset reports generated as samples now indicate the serial and asset numbers and the default custodian.

46. **We reiterate our recommendation to enhance the reporting capabilities of the Travel Module by considering user needs and using the most appropriate format to maximize the use of information. The ongoing efforts to review the reporting capability of iMIS must be pursued, to ensure inclusion of the travel monitoring report at the level of the initiator to facilitate compliance with policies on travel and eliminate duplication of manual reports in the field offices.**

B.2 GOVERNANCE MATTERS

47. Governance in the broad sense refers to the structures embedded and processes delivered to exact accountability and control within an entity. Acting in the interest of its Member States, taxpayers and other stakeholders at all times, the delivery of FAO's intended outcomes depends primarily on how accountabilities are defined and established within the Organization, how risks and vulnerabilities are managed, how programmes are delivered and how governance mechanisms result in an effective internal control. What is then required is the confluence of these core and high-level elements that make up governance. These actions are expected to enhance the Organization's relational value with its stakeholders and provide them assurance that their moneys are spent to achieve the organization's mandate. Such is the basic value delivered by good governance practices.

B.2.1 Preparedness to issue a Statement on Internal Control (SIC)

48. We noted that in April 2016, the Organization formally established its Internal Control Framework (ICF) to improve the achievement of expected results, use and stewardship of resources, and quality of information provided to the Governing Bodies and other stakeholders. As part of the ICF and as an added measure of accountability, the Organization intends to append a SIC to its 2017 annual financial statements. The SIC along with the Letters of Representation from senior managers to the Director-General will assert that controls over the operations within their spheres of accountability and FAO, as a whole, are adequate and functioning effectively. The institution of adequately-designed controls and the level of awareness across the organization are paramount, since internal control is dependent on the integration of mutually-supportive systems. These are the precursors of good internal control and must therefore be factored into the overall preparatory works before the disclosures on internal control is delivered.

Need to consider the dependency of internal control on Risk Management

49. During our review, we observed that the Organization pursues a risk management practice that is *proportionate, aligned with working practices, comprehensive, embedded* and *dynamic* to help managers and staff respond more effectively to uncertainty. As a component of FAO's ICF, risk assessment is expected to be *a dynamic and iterative process for identifying and managing the risks, including the risk of fraud, to the achievement of objectives.* Therefore,

if a risk management practice does not allow for the appropriate identification and assessment of risks within an appropriate context, any entity's controls would be invariably affected.

50. Concerns on the Organization's risk management practices have been raised since 2011. In our 2015 Long-Form Report, we pointed out that *risk management practices awareness in the Organization were becoming more widespread, but challenges still remain. These challenges include the need to strengthen contextual analysis and formal risk management documentation.* Our Report also provided that the *Organization should pursue its risk management more vigorously and not just view it merely as a compliance exercise* and recommended that *FAO ensure that risk management effectively permeates into its operational processes and decisions.* Noting the submitted progress by Management on the implementation of these audit recommendations, follow-up audit actions were then performed for which we provide observations below.

51. The results of our recent audits of several FAO's Departments, Regional Offices and Country Representations still highlighted the need for formal embedding of risk management starting with properly contextualizing the exercise through sufficient definition of the unit's objectives, and the issue on adequacy of technical support and backstopping. These results were corroborated with the work of Office of the Inspector General (OIG) in its 2016 Report. On these concerns, Management explained that it *has been systematically constructing a robust foundation for internal controls and risk management. These systematic steps provide a solid foundation ensuring internal control in all offices and for initiating annual Internal Controls Reporting, leading to the issuance of a Statement on Internal Control to accompany the 2017 financial statements.* Management also informed that it *will establish a comprehensive controls baseline to monitor subsequent progress* and the *requirement for actions to strengthen the enterprise risk management processes will be evaluated after the 2017 reporting cycle.*

52. We acknowledge and recognize the efforts undertaken related to risk management. However, the plan to establish a comprehensive controls baseline will require that it be anchored in concrete and well-functioning risk management practices, which we are still to observe in the Organization. In such a state, a challenge is placed into the substantive content and basis of the SIC having the *ICF, Accountability Policy and Policy on Risk Management as integrated and mutually supportive systems that ensure the Organization achieves its objectives*. We note that the Governing Bodies have already cited these concerns facing the Organization on risk management as it relates to internal control. The mutual dependency between risk management and internal control is important and should be viewed based on how controls are designed and delivered, all within the context of providing assurance and disclosure that the Organization's controls are operating as expected. Before a SIC can be issued, it is vital therefore that risk management practices within the Organization are well-entrenched to make the design of risk controls more effective, thus clarifying better the related accountabilities.

53. **We recommended that FAO ensure that its risk management practices effectively integrate with and support its ICF through an assessment of its current risk management practices prior to the initial issuance of the SIC to identify areas for enhancement that will guarantee a more efficient and effective design of risk controls and for clearer accountabilities.**

54. Management agreed that an assessment of current risk management practices conducted prior to the issuance of the SIC would be useful to inform follow-up actions.

Need to elevate the level of awareness of internal control arrangements

55. The adequacy and effectiveness of internal controls largely depends on *policies, procedures and process,* and *people*. Of these dependencies, *people* is viewed to be at the forefront. The FAO ICF states that, *staff are accountable for operating internal controls as prescribed in FAO rules, regulations, manuals, policies, procedures and other instructions.* The Organization's Accountability Policy further adds that, as part of the pillars of accountability, *all employees are accountable for the critical areas of performance - value-for money (economy, efficiency and effectiveness), accurate reporting, observing obligations and regulations, and protection against fraud, loss, waste, harm and damage*. This assertion is further supported by the 2016 OIG Report, which underscored the *attitude towards the control environment and awareness about the substance of controls.*

56. The results of our recent audits of various Departments, Regional Offices, Country Representations, and, information systems in FAO have highlighted areas where internal controls need improvement. This particularly refers to the monitoring and supervisory controls over key activities in various processes including programme management, travel management, donor reporting, procurement, cash management, human resource management, and asset management. We noted a lack of awareness *on details of the monitoring exercised at the higher levels of management in the Organization* and that *while policies and procedures are in place, they are triggered by ad hoc cases or issues rather than by a thorough review.*

57. The Report to the Internal Controls Steering Group (ICSG) on Pilot Testing in Preparation for Internal Controls Reporting for 2017 indicated that the *strengthening* of *internal controls requires changing behaviours at all levels of the accountability chain*. It further indicated concerns on the awareness of the *significance of internal controls reporting to FAO* and *to the participating managers*. With the positive developments on the planned SIC reporting, FAO's staff also need to have parallel support. The various departments queried on FAO's internal control arrangements indicated that *as new guidance is emerging continuously, efforts to make guidance and capacity development initiatives easily accessible and effectively implementable should be increased.* Management informed us that *the preparations on the completion of the 2017 Statement on Internal Control includes a carefully considered and wide-ranging communications programme involving all functional areas: corporate communications, finance and administration, programme management, the technical departments and the decentralized office network.*

58. In support of the preparation of the SIC, we noted that the Management's planned activities involve a wide scope of work relating to several administrative and technical functions. However, FAO's efforts to raise the level of control awareness through *regular corporate communications and at the departmental management meetings* still needs to be supported not just by the training courses made available to staff through you@FAO but by one that directly supports the preparation of the SIC.

59. We underscore that mere presence or existence of well-defined and outlined policies and procedures will not automatically translate to control adequacy and effectiveness. Control adequacy and effectiveness are measured against the backdrop of actual results delivery. This work also emphasises the need for an awareness level where the accountabilities over internal controls are known, performed and delivered, regardless of incentives, by everyone in the Organization. Building awareness post SIC issuance is a less effective strategy. Awareness should be on a level where control principles are adopted and supported before the planned issuance. Without this level of awareness that catalyses the buy-in and ownership attitude,

controls effectiveness and, even to a certain extent, adequacy will always be challenged. These matters clearly reflect issues needing improvement on awareness of the Organization's ICF.

60. **We recommended and management agreed that FAO should ensure that the internal control awareness across the Organization is elevated to a level that is aligned to the adopted internal control principles through effective competency building strategies before the SIC is issued to increase the level of assurance to be provided by the related internal control disclosures.**

B.2.2 Managing controls in key business processes

61. A strong foundation in internal control that promotes its effective functioning relies primarily on how the front line control activities are delivered to achieve intended results. In particular, these controls lie along the critical business and operational lines and are crucial in managing process risks. The embedding of internal control in the various operations and business units in any entity, therefore, serves the front-line managers in ensuring that specific internal control objectives are met and provides managerial insight to further improve control efficiency and effectiveness.

62. In relation to the planned issuance of a SIC by the Organization, these controls that serve as its first line of defense, need to offer assurance that the objectives set out by FAO are met. The improvement of controls and processes from a risk management perspective is, to a large extent, brought about by the recognition that the controls are embedded to manage business risks. We tested the operations of controls in the offices we visited for the financial year 2016, namely: HQ, AG, FAORAP, FAORLC, FAINS, FAMYA, FAOSD, FAPAK, FLARG, FRETH, FRKEN, and FRSOM. The results of our examination of controls over various critical processes within these Offices and which are discussed below revealed that much work still needs to be done in this area.

Need to address control deficiencies in key business processes

B.2.2.1 Procurement of goods and services

63. The principal objective of FAO's procurement activities is the timely acquisition of goods, works and services in a competitive and transparent manner, while ensuring fitness for purpose to meet user requirements, as well as the optimum combination of expected whole life benefit versus cost to procure or so-called "Best Value for Money." It is expected that all personnel involved in the procurement process are responsible for ensuring that their actions are in conformity with the Manual Section (MS) 502 in all areas of procurement. For the period under audit, the total value of POs raised by FAO for goods and services amounted to USD 146.3 million.

64. On the preparation of Procurement Plans (PPs), we observed that this was not fully observed in FAORAP and FAORLC while FAPAK and FRETH were observed to have incomplete PPs. Although FAINS, FAMYA and FAOSD have PPs, several deficiencies in the plans were also noted. Absence of and deficiencies in planning, can lead to risks of granting unnecessary exceptional awards and adoption of inappropriate procurement methods; lack of transparency; substandard quality of procured goods/services and late delivery of inputs/services/works.

65. On the performance of procurement roles and responsibilities, we observed that the procurement personnel in FAMYA, FAOSD, FLARG and FRKEN were performing incompatible functions. In FLARG, some of the members of the Local Procurement Committee (LPC) are those who process payments or are buyers or approving officers of the procurement action. Review of POs in FRKEN revealed that the same personnel performed functions in the procurement activities as buyer, requester, and/or member of the LPC and Tender Operating Panel (TOP). In FAMYA, three members of the LPC are also members of the Quality Assurance Unit. In FAOSD, a designated buyer also sits as a member of the LPC as the secretary. We stress that a fundamental element of internal control is the segregation of certain key incompatible duties so as not to compromise the integrity of a procurement transaction.

66. We also noted that in FLARG, 30 payments were not supported with formal Requests for Procurement, of which, 13 were supported only with a PO using the FAO-prescribed form while 17 were without a PO. Delays in deliveries, ranging from one to 49 days were likewise noted in the same Office. Similar delays ranging from 8 to 181 days were also noted in FAPAK. We further noted that in FAORAP and FAPAK documents pertaining to procurements were not uploaded in the GRMS system.

67. In FAINS, non-conformance of procured goods with required technical specifications were observed. We also noted that the selection method did not reflect the actual method used and change of delivery dates were made in GRMS to accommodate supplier requests. All the foregoing lapses indicate breakdowns in controls where success in the procurement undertaking was not achieved. These negatively affected project deliveries, the achievement of desired outcomes and may have presented a risk of loss as well.

B.2.2.2 Letters of agreement

68. FAO recognizes that there are non-governmental, voluntary and community organizations with capacities for high quality services needed by the Organization to fully actualize its commitments. FAO accesses this through Letters of Agreement (LOAs). MS 507 governs the use of LOAs which establishes the principles and rules warranting timely acquisition of services from eligible entities, in a transparent and impartial manner, with due consideration to economy and efficiency. For 2016, the Organization spent a total of USD 124.9 million under LOAs.

69. The results of our audit of LOAs showed that controls were generally in place except for some identified instances of non-compliance with reporting/documentation requirements, delayed completion, cancellations and non-observance of segregation of duties and authority limits. While these instances of non-compliance were observed to be anomalies, they indicate the need for more effective supervisory controls to ensure that accountabilities and deliverables emanating from LOAs are actualized along with compliance and operating efficacy and effectiveness requirements.

B.2.2.3 Human resource management

70. FAO Human Resource management guidelines and policies envisage transparent and competitive personnel selection; quality assessment or evaluation of performance; and adequate and systematic documentation. The Organization would otherwise be exposed to operational and information risks given the importance of human resources to the operations of the Organization particularly in decentralized offices. Hence, it is important that parameters defined in personnel selection, performance evaluation and the adequacy of relevant

documentation are observed. We observed that FAO had employee benefits and other personnel costs amounting to USD 389.4 million and consultant expenses amounting to USD 230.6 million for the year ending 31 December 2016. These amounts aggregated to USD 620.0 million representing 50 per cent of the total expenditures of the Organization for 2016.

71. The sampled non-staff human resource (NSHR) personnel records at FAORAP, FAORLC, FAMYA, FAOSD, FAPAK, FLARG, FRKEN, and FRSOM showed deficiencies in the maintenance of required personnel files such as those relating to the selection process, quality assessment reports (QARs), declaration of non-employment of family members, designation of beneficiaries, Basic Security in the Field (BSITF) and Advance Security in the Field (ASITF) certifications. Our review of the contents of the Terms of References (TORs) at AG, FAORAP, FAMYA, and FLARG identified gaps in the definition of roles, responsibilities and accountabilities including the non-identification of start and end dates, category, completion date of expected output, non-specification of outputs and corresponding indicators, and inclusion of blanket provisions.

B.2.2.4 Cash management

72. The Financial Rules include instructions of the Organization on the authorization, utilization, recording, custody and reporting of cash. As also laid down in FAO's ICF for stewardship of resources, managers and staff throughout FAO are required to apply policies and processes to reduce losses and wastage of assets and resources, whether through misdirected effort, avoidable errors, mismanagement, abuse or fraud. This is to further ensure that the actions of FAO managers and staff are in furtherance of the Organization's mission. We evaluated the Organization's cash management practices and assessed whether there is compliance with existing financial rules and regulations governing the different facilities used to settle financial obligations, and whether prescribed controls were in place and operating effectively for Cash in Banks, Regular Petty Cash, Out-posted Petty Cash (OPC), Operational Cash Account (OCA), and other Imprest Accounts. We also assessed FAO's use of cash-based transfers (CTs).

73. During our review, we determined that FAO, with operations in 196 countries, has 240 separate bank and cash accounts at the end of 2016. FAO Headquarters operated and directly managed 21 bank accounts in Europe. For 2016, FAO reported cash and cash equivalents of USD 684.7 million, a 33 per cent increase from 2015 mainly due to the accelerated receipt of cash. Of the said amount, USD 595.9 million (or 87 per cent) were held in short term deposits and investments and USD 88.8 million (or 13 per cent) were in operational bank accounts. We also noted that FAO dormant, disabled and end-dated cash accounts still appeared in the year-end trial balance.

74. Audits in FAINS and FAOSD highlighted matters relating to authorization including amounts approved in excess of requirements, significant returns of unused amounts and inadequacy of the request form for OCA. Gaps in cash utilization such as maintaining the minimum level, disbursements exceeding the allowed limit, delayed reimbursements and absence of the required voucher were noted in FAORLC, FAOSD, FLARG, FRETH, FRKEN and FRSOM. Issues on custody resulting from non-segregation of incompatible duties and the performance of cash responsibilities by NSHR were observed in FAMYA, FRETH and FRKEN. Issues observed in the recording and reporting of cash included the presence of long outstanding bank reconciling items in HQ, outstanding commitments in FAPAK, granting of new advances despite their being unliquidated previous advances outstanding in FRETH and FRSOM, and issues with the GRMS facility identified in FAINS, FAOSD and FRSOM.

75. Furthermore, our reviews conducted in FLARG and FRKEN identified some areas of concern on CTs. These include the inadequacy and inaccuracy of supporting documents, non-observance of procedural guidelines, and the absence of guidance to prevent double payments. Based on these observations, we emphasize the importance of effectively managing the cash of the Organization. Management should ensure that activities and controls over the administration of its cash resources are sufficient and functioning at a level that provides adequate safeguards and ensures effective utilization.

B.2.2.5 Asset and inventory management

76. As at 31 December 2016, FAO reported inventories amounting to USD 9.3 million. The majority of USD 8.2 million (89 per cent) of the reported inventories were project inputs. Of these project inputs, USD 5.6 million are in the Regional Office for Africa. Property, plant and equipment, net of depreciation, accounted for USD 24.5 million. Of this amount, motor vehicles made up 60 per cent or USD 14.7 million. To manage these resources, FAO MS 202.10.4 and MS 503 prescribe the processes and controls for the maintenance of records, custody and safekeeping, conduct of physical verification, transfers, and disposal of assets. Weakness in any of these processes can result in asset loss or wastage detrimental to the operations and delivery of commitments of the Organization.

77. In our audits of FAPAK and FRSOM, we noted that there were undistributed project inputs pertaining to prior years and operationally and financially closed projects. Our reviews also identified the need for continuous maintenance of asset information evidenced by assets without tag, missing serial numbers, unnamed assets or missing information in the GRMS Asset Register at AG, FAORAP, FAORLC, FAINS, FAMYA, FAOSD, FLARG, FRETH, and FRKEN. The evaluations on FAOSD, FLARG and FRKEN identified that the FAO Property Loan Form was not utilized and asset numbers and cost/residual values were not completely or accurately filled out.

78. Our review of selected asset disposals at FAORAP, FAINS, and FLARG through sale, donation or write-off, highlighted that required timelines were not followed, third party estimate of the wholesale value of the assets were not obtained, required forms were not completed, disposal receipts were not made available, and approval by CSF was not obtained before disposal of assets. Even though these observations did not have any material financial impact, we highlight the importance of properly performing and monitoring the management of assets and inventory activities to limit exposure against loss or wastage.

B.2.2.6 Travel management

79. Travel in FAO is an essential factor in the implementation of FAO's programmes and projects and is one of the major components of the Organization's budget. In 2016, FAO reported travel expenses aggregating to USD 94.3 million representing 7.6 per cent of the total expenses incurred during the year. FAO has set out specific policies in MS Chapter IV and procedures in addition to the travel manual aimed to simplify and streamline processes in various phases of travel which include planning, approval, payment and the related final processing of travel claims. All of which is geared to improve efficiency and effectiveness.

80. During the reviews of AG, FAORAP, FAOSD, FAPAK, FLARG and FRETH, we noted gaps pertaining to travel planning that included the non-uploading of Quarterly Travel Plan (QTP) in the GRMS and the existence of unplanned travels among others. In FAORAP,

FAORLC and FAOSD, issues relating to delays in approval and grants of additional travel without settlements of previous trips were identified. We also noted concerns in the final processing of travel claims including the submission of TECs beyond the prescribed period in FAORAP, FAORLC, FRKEN and FRSOM and the non-settlement of outstanding travel advances in FAOSD.

81. These control gaps were attributed to factors such as lack of documentary requirements supporting the TECs, delayed uploading of BTORs due to the review and clearance process that is done off-line, non-uploading of QTPs in the GRMS, limitations in the QTP functionality especially the inflexible approval process and the absence of system notifications that block new advance payments for duty travels. The foregoing observations highlight issues pertaining to compliance with the existing travel policies and procedures of the Organization that may, in one way or another, affect the delivery of its commitments.

82. Overall, the foregoing audit observations highlight the importance of placing more emphasis on delivering better control procedures across these routine but critical processes. These controls primarily relate to the need for adequate supervisory or monitoring controls that ensure compliance with rules and regulations and efficient performance of activities within the Organization and to manage its risks and vulnerabilities. In addition, there is a need to improve the performance of management controls along the processes of: procurement of goods and services, letters of agreement, human resource management, cash management, asset and inventory management and travel management.

83. **We recommended that FAO optimize the performance of its management controls around critical operational processes through more robust monitoring and supervision of the performance of these controls and ensure that key controls in every critical process are closely monitored to improve process performance, accountability and management decisions.**

84. Management agreed with this recommendation noting that many actions have already been taken to address the issues identified and that further actions would be taken during 2017.

B.2.3 Managing Controls in Projects

B.2.3.1 Field Project Management Information System (FPMIS)

85. For over a decade, the web based Field Project Management Information System (FPMIS) has been considered an essential tool for project and budget management that enables its users to adhere to the defined Project Cycle Standards through embedded operational workflows from project identification and formulation to implementation and monitoring activities.

86. The results of our previous audits of projects and programmes across several regional and country offices identified several concerns on the need to improve performanc**e,** particularly in the areas of efficiency and effectiveness of information processing which impacted on decision-making and transaction cost controls. The iterative issues that we have noted from these audits mainly dealt with outdated, incomplete and unreliable information. Likewise, challenges were raised in the uploading in FPMIS of reports, matrices, plans, information on financial reports and other relevant documents. These were compounded by the persistent observations on delayed approvals, implementation, closures, reporting, and lapses in monitoring performance.

87. For the FPMIS to satisfy these diverse needs, it has to meet the requirements in each of the significant phases of the project cycle with optimally-functioning process controls. The System also has to be efficient and effective in relation to the needs of the users and in providing information for monitoring and decision-making purposes. These defined requirements also drove our review as we undertook the procedures and techniques, including the conduct of a User Satisfaction Survey to extract the needed data for our analyses and in pursuance of our objectives of determining the causes of deficiencies and identifying system improvements.

Need to make the System user friendly and adaptable by average user

88. Based on the overall result of the survey, users recognized the FPMIS as the only tool supporting project management**.** However, a significant number of responses highlighted issues of the System not being not user-friendly and flexible. Specifically, the users' highlighted issues with the Quality Assurance facility that manages the populating of the Logical Framework Matrix (LFM), sub-windows that create confusion, and requirements for data that are too specific and not flexible. Users also recommended the inclusion of indicators to monitor qualitative aspects of project implementation in the LFM monitoring. Overall, the survey results indicated the need for a simpler system with easy-to-use functionalities without sacrificing information integrity and requirements of the Organization.

89. Fundamental to any information technology architectural structure is its compatibility with the intended user's ability to use it easily and address vital requirements. FPMIS, as an information and project monitoring tool, should have functionalities that are user-friendly and simple to be understood by all users. The responses from the majority of system users considered in the survey confirmed the outdated state of the tool.

90. Further inquiry and analysis of management documentations and navigation of the FPMIS, GRMS and iMIS showed that the root cause of the issues identified by users is the lack of linkage of all the interrelated systems. While we commend FAO on its recently issued Digital Strategy envisioned to deliver an integrated solution and platform that can meet the requirements of the Organization, this strategic perspective has to be executed in close collaboration with relevant offices to develop an integrated solution design that is agreed by all concerned players guided with definite roles and responsibilities and tight coordination on agreed commitments.

91. **We recommended that FAO:**

a. revisit/update the Navigation Improvement Recommendations to make the System user-friendly so that this will become acceptable to the intended users, thus, advancing the level of usability of functionalities;

b. capture the delays in the submission of final financial reports to donors under the existing Field Programme Support Network (FPSN) quarterly monitoring facility in coordination with CSF, given that the final financial report comes chronologically after financial closure, and consider the uploading of the duly received covering letter of financial reports by the donor for better compliance with donor reporting; and

c. **improve the functionalities in the LFM, work plan monitoring and budgeting to make it more flexible and adaptable to project requirements, and to include indicators to monitor qualitative aspects of project implementation.**

92. **We also recommended that based on the results of the FPMIS survey, that FAO conduct a comprehensive analysis of the crucial issues identified by system users to obtain better clarity in defining its roadmap to deliver an integrated solution and in prioritizing its activities, moving forward.**

93. Management agreed to streamline the functionalities of the FPMIS system in the context of reviewing and resolving project-related financial policy issues and project cycle procedures and in the context of the FAO Digital Strategy as appropriate.

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Need to address the complexity in functionalities for Budget, Final Financial Report and other access issues

94. Our review of the various policies, procedures, guidance and processes in the project cycle phases and its corresponding inclusion in the system design disclosed several functionalities that are complex and wide-ranging with extensive procedural steps and procedures prior to project implementation, which are related to FAO meeting fiduciary standards of donors.

95. The presentation of budgets with results-based donor requirement also continues to be a challenge. The tool existing in FPMIS caters to project budgets by results, however, the expenditures are presented according to the General Ledger segment of account type and not against results. Correspondingly, financial reporting is also not presented using results-based principles to facilitate donor-based reports. Budget management and reporting of expenditures by results remain largely manual processes and in addition, the complexities of budget fungibility and equalization rules have yet to be addressed.

96. We also noted that the List of Equipment for projects, a major requirement in project closure, is no longer accessible in the FPMIS. The Budget Holder (BH), before financial closure, ensures that all non-expendable equipment of the project has been transferred and removed from the project record. This activity requires the BH to determine the equipment charged to the project for proper disposal to be able to facilitate closure of projects.

97. **We recommended that FAO step up its process and integration enhancements of the related systems, particularly focusing on the following:**

a) **inclusion of sub-lines segment in the GRMS to ensure that project expenditures can be easily and systematically monitored and reported by results and taking into consideration the effects of budget equalization;**

b) **restoration of the asset link with GRMS to enable the availability of the list of equipment in the FPMIS;**

c) **provision of link between financial data in FPMIS with GRMS for generation of information in real-time, and inclusion in the single log-in access of iMIS as this is the access design for all interrelated systems; and**

d) **inclusion of budget fungibility segments in GRMS in support of the existing module in FPMIS for effective monitoring of projects at the point of commitment and expenditures.**

98. Management agreed with the importance of integrating and enhancing the related accounting and MIS systems in the context of reviewing and resolving project-related financial policy issues and project cycle procedures. Management noted that the recommendations for specific enhancements to FPMIS and GRMS functionality will be considered in the context of the comprehensive review underway of the requirements for efficient and effective project management, control and reporting tools as part of the FAO Digital Strategy.

Need to intensify training on the use of FPMIS

99. Training plays a key role for establishing the quality of information systems or technology tools through the use and the level of satisfaction by end-users. Adequate training improves awareness on the potential of technology tools, increases productivity and contributes to the better performance of staff. Another major root cause for the issues identified by users is the inadequate training of users**,** resulting in low or non-appreciation of the existing features and information available in the system. Users also highlighted that their interaction with the System was limited to compliance.

100. The 2015 Capacity Building Programme reported that 370 staff in 10 locations attended training on updated features of FPMIS and project implementation trainings were also offered to 186 participants from September 2016 to March 2017 in eight decentralized offices. However, our assessment disclosed that there are still staff or those new to their position such as BHs and programme/project officers who are inadequately trained or are without formal training. The results of our survey demonstrated the need for more trainings to be conducted on a regular basis with a broader scope of participants based on their role in project management.

101. While relevant materials exist as additional tools to enhance capacity building on the use of FPMIS, hands-on training and a dedicated help-desk to immediately address specific queries on retrieving documents and data are the preferred mechanisms of the users. The "*How to*" feature in FPMIS needs to be revisited and revised with concise instructions and within the context of the users' needs.

102. **We recommended that FAO intensify the training of FPMIS users with broader participation based on all roles in project management, and consider other capacity building mechanism that will benefit system users on an organization-wide basis.**

103. Management confirmed that an enhanced training programme on project management is under preparation and that training and capacity building will also represent an integral part of the road-map and implementation of the integrated solution as part of the FAO Digital Strategy.

B.2.3.2 Technical Cooperation Programme

104. For the biennium 2016-2017, the adjusted net appropriation for the Technical Cooperation Programme (TCP) was USD 132.9 million. The delivery of TCP is guided by the

basic principles found in the TCP Manual and relevant guidance prescribing the reasonable time from project inception to approval; timeliness of delivery; resource commitment of up to 70 per cent of the country allocation during the first year of the biennium; the level of TCP project delivery; and reliability of TCP project information in the FAO systems. Our evaluation of delivery runs along these accountability lines to ensure efficient and effective achievement of TCP commitments.

Need to further improve TCP project delivery

105. Our evaluation noted that as at 31 December 2016, total project approvals amounted to USD 80.3 million which was 60.4 per cent of the 2016-17 net appropriation for TCP. The total delivery for TCP projects as at 31 December 2016 was USD 13.9 million representing 21 per cent of the 2016 share of the appropriation. In addition, expenditure in 2016 against the 2014-15 TCP appropriation was USD 50.0 million. Average monthly expenditure on the TCP during 2016 amounted to USD 5.3 million which compares favourably with the figure of USD 4.8 million in 2014 (first year of the previous biennium) and USD 5.2 million for the biennium 2014-15. Concerns on low delivery level were highlighted in our audits of FAORLC, FAMYA, FAOSD, and FAPAK. In addition we highlighted issues related to time lags on project start-up in FAORLC, FAMYA, FAOSD, FAPAK, and FRSOM, prompt project closures in FAORLC and the availability of up-to-date and accurate project information and related documents in FAO systems that affects monitoring and reporting in our reviews of FAORAP, FAORLC, FAINS, FAMYA, FAOSD, FAPAK, FLARG, FRETH, FRKEN, and FRSOM.

106. Project time lags and the consequential low level of expenditure are mostly correlated with the complex dynamics of project clearances and approval processes that affect timeliness of project actualization. This is also compounded by the effects of challenges on delivery of project accountabilities by process owners, in particular project managers and BHs, which lead to impacts on project execution, closure procedures, and availability of information and related documents in the FAO systems. We recognize the on-going efforts of Management, in particular through the launching of the Operational Monitoring Dashboard, systems development and collaborations, to help manage and improve overall project delivery. However, areas of work still remain in TCP as highlighted by the above issues.

107. **We recommended that FAO ensure the overall efficiency and effectiveness of TCP projects through mechanisms that exact responsibilities and properly manage events or instances affecting the promptness, level, and adequacy of information on TCP commitment delivery.**

108. Management noted that roles and responsibilities are clearly defined in the Project Cycle guide and have enabled improved overall efficiency and effectiveness of TCP projects. The delivery rate of TCP projects has also been improved through use of the monitoring tools and the inclusion of the TCP general provision to the CPF annex which avoids delays in the startup of project activities.

B.2.3.3 Projects funded by voluntary contributions

109. In our assessment of the implementation of projects funded by voluntary contributions, we considered accountability and control parameters, and determined if the prescribed project

implementation and monitoring guidelines were observed. Similar to our approach for TCP projects, our evaluation looked into the factors of effective and efficient project implementation and monitoring which include timely project delivery, level of project delivery, and adequacy of monitoring and the utilization of FAO system for information availability. What magnifies the importance of properly managing the delivery of projects funded by voluntary contribution is the sheer magnitude of FAO's reliance on extra-budgetary resources to achieve its mandate. It is worth mentioning that 61 per cent or USD 1.572 billion of FAO's adjusted PWB for 2016-17 of USD 2.578 billion are from extra-budgetary sources.

Need to further improve delivery of trust fund projects

110. Time lags on project start-up were identified in our audits of AG, FAORLC, FAINS, FAMYA, FAOSD, and FRKEN. Issues on low level of project delivery were pointed out in the evaluations of FAORAP, FAINS, FAMYA, FAOSD, FRETH, and FRSOM. Challenges on prompt project closures were noted in the reviews of HQ, FAORAP, FAORLC, FLARG, and FRSOM. Concerns on the availability of project information and related documents in FAO systems that affect monitoring and reporting were underscored in HQ, AG, FAORAP, FAORLC, FAINS, FAMYA, FAPAK, and FRSOM.

111. In general, project time lags on project start-up were caused by the considerable time needed to acquire the approval of the counterpart or recipient government and the lengthy process required for the recruitment of qualified project personnel. On the other hand, our audit noted issues on the low level of project delivery, delayed projects closures and the unavailability of project information and related documents in FAO systems and which are predominantly brought by challenges in the delivery of project accountabilities of concerned process owners. We acknowledge however, the actions of Management on improving the overall efficiency and effectiveness of project implementation, but the gaps noted are evidence of the need for sustained efforts.

112. **We recommended that FAO ensure that voluntary funded projects are carried out through activity and monitoring controls that bolster adequate identification and proper management of factors and delivery of project accountabilities that affect the overall efficiency and effectiveness of project implementation.**

113. Management confirmed that it would continue to ensure effective monitoring and control of projects, including through the use of the iMIS dashboard, system improvements and developments, and provision of updated operational guidelines and continuous support to budget holders.

Need to provide policy on unspent balances of projects

114. Our audit of HQ pointed out that as at 30 September 2016 the total unspent cash for all financially closed projects funded from voluntary contributions amounted to USD17.9 million. Our review noted 11 financially closed projects with a total approved budget of USD 93.4 million with unspent cash balances totaling USD 2.1 million. These unspent balances were not yet returned to resource partners nor transferred for use in another project. Management noted that the main reason for unspent balances still being on FAO books related to the need to receive the resource partner's instructions for the disposition of the remaining funds, including confirmation of banking details when funds are to be returned.

115. While it was acknowledged that some donors do not wish to include provisions on the disposal of unspent cash in the funding agreement, we underscore that failure to comply or delays in complying with donor requirements if they exist may create a negative impression of the Organization's efficiency in the disposal of unspent cash.

116. **We recommended that FAO consider incorporating a specific provision in all funding agreements it entered into with its resource partners on the disposition of unspent balances, together with the options for the proposed use of the remaining funds in case donors will not respond to requests for refund instructions within a specific period.**

117. Management confirmed that FAO promotes the adoption of framework agreements or standard agreements with its resource partners and whenever compatible with the rules of its partners, proposes that the framework agreement include provisions regarding the use of any unspent funds. It also promotes the transfer of any unspent emergency funds at the end of the project to be allocated to SFERA and for non-emergency programmes to the newly established Special Fund for Development Finance Activities (SFDFA).

B.2.3.4 Reporting to donors

118. As an accountability mechanism, reporting to donors on the implementation of financial and programmatic commitments in agreed frequency during the project (progress reports) and at completion (terminal reports) affords resource partners information from which next steps are determined and crucial decisions are made. It is important that project delivery responsibilities are carried out and that reports containing fair, reliable and relevant financial and non-financial information on financial and programmatic results and achievements are provided to funding partners. The ability of FAO to meet reporting demands increase~~s~~ the trust of external partners and stakeholders towards the Organization, thus attracting additional resources and creating a more enabling environment for the achievement of its objectives. Conversely, any challenges along this reporting accountability line increase exposures relating to resource availability of the Organization, especially given that most of its programmatic work is dependent on voluntary contributions.

Need to improve compliance with reporting to donors

119. Noting the above, we evaluated FAO's donor reporting delivery. Our recent audits of AG, FAORAP, FAORLC, FAINS, FAMYA, FAOSD, FAPAK, FLARG, FRKEN, and FRSOM identified that reporting to resource partners is still challenged by issues on delivery of project responsibilities of process owner**s,** causing projects to exceed target accomplishment dates, project closures to be delayed and project reporting information to be amiss. While we acknowledge the on-going efforts to improve the overall project management, the matters identified above emphasize the need for sustained efforts to fully manage the delivery of reporting responsibilities for voluntary funded projects.

120. **We recommended that FAO ensure the delivery of its donor reporting accountability through sustained efforts of monitoring activities and controls that exact and backstop delivery of project responsibilities of process owners, and assure that systems provide timely, reliable and relevant information.**

121. Management confirmed that it would continue to ensure effective monitoring of projects, including through the use of the iMIS dashboard, noting that weekly monitoring

reports are sent to budget holders and their supervisors to remind them to complete activities and proceed with reporting and closures on time.

B.2.4 Managing Risks

B.2.4.1 Risk management

Need to address challenges in embedding risk management

122. Through its Corporate Policy on Risk Management, the Organization pursues a risk management practice that is proportionate, aligned with working practices, comprehensive, embedded and dynamic to help managers and staff respond more effectively to uncertainty. All management levels are expected to identify, monitor and address risks within their areas of control and accountability. Risks vary among and between departments, divisions, decentralized offices and even projects. By cascading risk management, lower levels of management provide feedback on how risks are contextualized, identified, monitored and addressed which in turn feeds information to higher level risk management activities especially for risks requiring action from higher levels of management. Risk management is envisioned to be formalized and integral to all business process levels and should be observed by everyone in FAO.

123. While we recognize the efforts undertaken in ensuring that risk management permeates into the Organization's operational processes and decisions, much work on embedding risk management still remains to be undertaken. Results of our recent audits with respect to formal and concrete risk management provided matters needing action. These include the proper contextualization of the risk assessment, the adequacy of documentation, and the provision of resource and technical backstopping. We emphasize that having properly embedded, monitored and well-backstopped risk management practices across all delivery fronts of the Organization are now more crucial than ever as the Organization positions itself to issue the SIC by end of 2017. In this regard, efforts should be made to provide the integration of risk management into a coherent and comprehensive framework along with the ICF and Accountability Policy to enhance FAO's ability to meet its objectives and deliver the benefits and purpose expected by its stakeholders.

124. The results of our audit showed that a variety of challenges still continue to persist within the Organization as it adapts to the rudiments and requirements of risk management. The issues identified in our review indicate that fundamental challenges are manifested in the Organization's adaptive capacity and in the shared concept of risk management. These challenges have not reduced from 2011, the year when risk management was formally introduced in the Organization. The organizational risk management outlook now needs to be revisited to achieve better focus, align perspective and improve methodology. This will ensure that intended benefits of risk management are harnessed and its value is realized.

125. **We recommended and Management agreed to revisit its risk management framework and the process by which it is being adopted, craft strategies to embed this across all levels of the Organization, and ensure that its adaptive capacity is fully considered and that the shared concept of risk management is embraced by all stakeholders to achieve the intended benefits of risk management.**

B.2.4.2 Fraud risk response mechanisms

126. FAO Administrative Circular No. 2015/08 contains the *Policy Against Fraud and other Corrupt Practices* and reflects that the Organization has adopted a zero-tolerance policy in respect to fraud and other corrupt practices in all their manifestations. The said circular requires decentralized offices to establish, maintain and implement a Fraud Control Plan (FCP). Taking note of the actions to implement our previous recommendation on the matter, we evaluated the FCPs of FAORAP, FAORLC, FAINS, FAMYA, FAOSD, FAPAK, FLARG, FRETH, FRKEN and FRSOM to determine whether controls and mechanisms are adequately designed and kept up-to-date to prevent and detect fraud vulnerabilities.

Need to update FCPs

127. Results of most evaluations underscore the challenges of keeping these FCPs dynamic and updated in face of fraud susceptibilities. Observations also highlight a common flaw in terms of managing fraud risk that is treating fraud like any other business infractions. Fraud risks materialize through malicious intent and control circumvention; hence, fraud prevention and detection controls should be adequately designed to address this. This requires that measures are defined, in place and constantly monitored for effectiveness and relevance which increase the perception of detection, reinforce segregation of incompatible functions, ensure safeguarding resources and affirm compliance with regulations. The dynamism and updating of FCPs should run along this line to fully address fraud exposures.

128. **We recommended that FAO ensure that its fraud vulnerabilities are properly managed through mechanisms that champion dynamic and up-to-date FCPs replete with measures which increase the perception of detection, reinforce segregation of incompatible functions, ensure safeguarding of resources and affirm compliance with regulations.**

129. Management confirmed that required measures have been put in place to strengthen and communicate the frameworks for accountability and internal control, in particular to Decentralized Offices, including the regular update of the Fraud Control Plan.

C. DISCLOSURES BY MANAGEMENT

130. The terms of reference on External Audit require the disclosures of important information. In this section, Management provided disclosures on write of losses, ex-gratia payments and cases of fraud and presumptive fraud.

C.1 Write-off of losses of cash and receivables

131. In 2016, write-offs amounting to USD 69,387 for receivables from exchange transactions and USD 29,235 for government counterpart contributions were made. These write-offs were authorized by the Assistant Director-General for Corporate Services pursuant to MS 202.10.6 and 202.10.7.

C.2 Ex-gratia payments

132. Management reported that there were no ex-gratia payments made by the Organization in financial year 2016.

C.3 Cases of fraud and presumptive fraud

133. Pursuant to paragraph 6(c)(i) of the Additional Terms of Reference Governing External Audit (Annex 1 to the Financial Regulations), Management reported cases of fraud and presumptive fraud. Management disclosure on fraud is prepared in light of its definition as contained in the *Policy against Fraud and Other Corrupt Practices*, which was introduced on 12 March 2015 in Administrative Circular No. 2015/08. Regarding presumptive fraud, the disclosure has been prepared in light of the definition of presumptive fraud recommended by the UN Joint Inspection Unit in its Report No. JIU/REP/2016/4**,** paragraph 34.

134. There were four cases of fraud that were closed in 2016 which were under review in 2015. These cases included: 1) the misappropriation of the Organization's resources by a staff member; 2) a staff member in a country office had misused the Organization's resources when he changed the method that had been used for payments made to a former employee, then issued a check for approximately USD 940 to that employee which he cashed for himself; 3) a former staff member may have submitted claims for reimbursement of medical expenses amounting to approximately USD 1,800 that had in reality been partially or totally covered by other insurance policie**s,** or otherwise had never been paid by the former staff member to the relevant medical practitioners; and 4) a vendor had provided fraudulent paperwork to demonstrate the provenance and type of seeds supplied to a FAO office.

135. Of the eight cases of fraud in 2016, the Organization successfully resolved six cases as at 31 December 2016 while the remaining two were closed in the first quarter of 2017. The six cases resolved in 2016 included: 1) a NPP employee and a PSA subscriber in a country office engaged in a collusive practice in breach of the procurement rules involving unauthorized disclosure of confidential information on tenders for goods and services; 2) a NPP employee in a country office was involved in the disappearance from a storehouse of goods valued at USD 8,510; 3) a staff member of a country office engaged in fraudulent practices involving procurement fraud and entitlement fraud related to rental subsidy; 4) in relation to the previous case, a PSA subscriber assisted his supervisor, a staff member, in submitting fraudulent documentation in support of the supervisor's rental subsidy; 5) a staff member in a country office made false representations regarding the circumstances in which damage to an official vehicle occurred; and 6) a staff member in the General Service category and three NPP employees of a country office engaged in fraudulent activities, resulting in estimated financial losses to the Organization as identified by OIG investigations.

136. The two 2016 cases of fraud closed in 2017 include: 1) an implementing partner making fraudulent representations regarding implementation of its LoA with the Organization**;** and 2) a supplier misrepresenting individual expense payments totaling approximately USD 577,000, and fraudulently charging approximately USD 26,000 in commission on those payments. As of the writing of this report, there are six ongoing matters of presumptive fraud under investigation.

137. We noted that the cases of fraud for 2016 were a case less than that of 2015. Of these cases, 75 per cent or six out of the eight cases of fraud or presumptive fraud were committed by staff members and 25 per cent or two out of the eight cases involved third parties. All these point to the need for strengthened and sustained fraud risk governance.

138. **We recommended that FAO continue to strengthen its fraud risk governance through processes and mechanisms that afford adequate fraud risks identification and definition of responses for better management of its fraud exposures.**

139. Management confirmed that measures have been put in place to strengthen and communicate the frameworks for accountability and internal control and the importance the Organization pays to internal control, risk management and fraud detection, raise staff awareness of the types of unsatisfactory conduct and possible disciplinary consequences as well as facilitate general understanding by staff members of the disciplinary process.

D. ACKNOWLEDGEMENT

140. We wish to express our appreciation for the cooperation and assistance extended to the External Auditor by the Director-General, Deputy Directors-General, Assistant Directors-General, Regional Representatives, HQ Directors, Director of Finance, Country Representatives and their staff during our audit.

Michael G. Aguinaldo
Chairperson
Commission on Audit, Republic of the Philippines
External Auditor

Quezon City, Philippines
07 July 2017

List of Acronyms

Acronym	Description
AG	Agriculture and Consumer Protection Department
AR	Accounts Receivable
ASITF	Advanced Security in the Field
ASMC	After Service Medical Coverage
BH	Budget Holder
BSITF	Basic Security in the Field
BTOR	Back-to-Office Report
CIO	Information Technology Division
COIN	Country Office Information Network
CSF	Finance Division
CTs	Cash-based Transfers
FAINS	FAO Representation Offices in Indonesia
FAMYA	FAO Representation Offices in Myanmar
FAO	Food and Agriculture Organization
FAOPK	FAO Representation Offices in Pakistan
FAORAP	FAO Regional Office for Asia and the Pacific
FAORLC	FAO Regional Office for Latin America and the Caribbean
FAOSD	FAO Representation Offices in Sudan
FC	Finance Committee
FCP	Fraud Control Plan
FLARG	FAO Representation Offices in Argentina
FPMIS	Field Project Management Information System
FPSN	Field Programme Support Network
FRETH	FAO Representation Offices in Ethiopia
FRKEN	FAO Representation Offices in Kenya
FRSOM	FAO Representation Offices in Somalia
GEF	Global Environment Facility
GL	General Ledger
GRMS	Global Resource Management System
HQ	Headquarters
ICF	Internal Control Framework
ICSG	Internal Controls Steering Group
*i*MIS	Integrated Management Information System
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
LFM	Logical Framework Matrix
LOAs	Letters of Agreement
LPC	Local Procurement Committee
MS	Manual Section
NPP	National Project Personnel

Acronym	Description
NSHR	Non-Staff Human Resource
OCA	Operational Cash Account
OIG	Office of the Inspector General
OPC	Out-posted Petty Cash
PO	Purchase Order
PPs	Procurement Plans
PSA	Personal Services Agreement
PWB	Programme of Work and Budget
QAR	Quality Assessment Report
QTP	Quarterly Travel Plan
SFDFA	Special Fund for Development Finance Activities
SFERA	Special Fund for Emergency and Rehabilitation
SIC	Statement on Internal Control
SRL	Staff-Related Liabilities
TCP	Technical Cooperation Programme
TEC	Travel Expense Claim
TOP	Tender Operating Panel
TORs	Terms of References
TPF	Terminal Payment Fund
UN	United Nations
UNDP	United Nations Development Programme