



SEVENTH ITEM ON THE AGENDA

**Report of the Chief Internal Auditor for
the year ended 31 December 2003**

**Report of the Chief Internal Auditor on
significant findings resulting from internal
audit and investigation assignments
undertaken in 2003**

1. In accordance with the decision taken by the Governing Body at its 267th Session (November 1996), the Director-General transmits herewith the report of the Chief Internal Auditor on significant findings resulting from audit and investigation assignments carried out during 2003 (see appendix). The Chief Internal Auditor's report also takes into account the audit and investigation findings of 2002 following a recommendation of the External Auditor to submit a biennial report of the results of his work.
2. The Director-General considers the work performed by the Chief Internal Auditor to be extremely valuable in assessing strengths and weaknesses in operations, practices, procedures and controls within the Office. Recommendations made by the Office of Internal Audit and Oversight are thoroughly evaluated, and there is constant dialogue between managers and the Chief Internal Auditor to give effect to them.

Geneva, 13 February 2004.

Appendix

Report of the Chief Internal Auditor on significant findings resulting from internal audit and investigation assignments undertaken in 2003

Introduction

1. The Office of Internal Audit and Oversight (IAO) of the ILO fulfils an independent oversight function established under article 30(d) of the Financial Regulations. Through audit, inspection and investigation processes, the IAO determines the adequacy and effectiveness of the Organization's system of internal control, financial management and use of assets. Its aim is to provide reasonable assurance that the activities have contributed to the attainment of the Organization's goals and objectives. More specifically, to achieve this, the IAO reviews and appraises accounting, administrative and operating controls; evaluates the responsible, efficient and economic use of the Organization's resources; ascertains the extent of compliance with established rules, regulations, policies, procedures and plans; determines the extent to which assets are accounted for and safeguarded from loss; assesses measures taken to prevent fraud, waste and malfeasance; ascertains the reliability of financial and management information; and examines the adequacy of the planning and monitoring system with regard to the operations, functions, programmes and activities within the Organization. Where necessary, the Chief Internal Auditor makes recommendations to improve their adequacy, efficiency and effectiveness. The IAO adopts a proactive approach to facilitating the assessment of risks and controls, and promotes a learning culture in support of management's process to enhance efficiency, effectiveness and value for money in the activities of the Organization.
2. The Office of Internal Audit and Oversight does not develop or install procedures or engage in any activity that it would normally review or appraise or which could be construed as compromising either its independence or objectivity. The IAO has full and free access to all records, personnel, operations, functions and other material relevant to the subject matter under review. Its monitoring procedures are systematized to ensure that all audit recommendations are properly followed up by management and implemented.
3. In June 2002, at their 33rd annual meeting, the Representatives of Internal Audit Services of United Nations Organizations and Multilateral Financial Institutions adopted the new Professional Practices Framework promulgated by the Institute of Internal Auditors (IIA). The Internal Audit Manual, which is about to be issued, fully incorporates the new IIA standards. In December 2003, the IAO also endorsed the uniform guidelines for investigations that were adopted at the 4th Conference of International Investigators.
4. The IAO's detailed programme of work was coordinated with the External Auditor and all audit findings and recommendations were communicated to the External Auditor.
5. Following up on a recommendation of the External Auditor, this report covers the combined results of audits and investigations carried out in 2002-03. The audit and investigation results indicate that, on the whole, the system of internal control within the ILO continues to operate satisfactorily. There were, however, recurring systemic internal control weaknesses regarding field operations which have also been raised in previous years. They pose risks to the Organization. Indeed the internal control weaknesses have allowed the perpetration of financial irregularities going undetected over a long period of time, in two cases. As such, the Office needs to obtain improvement in the quality of the regional verification of financial reports, review its focus on training given to

administrative support staff, and enhance its briefing and orientation of staff with management responsibilities regarding operational and financial controls. The Office has recognized the importance of operational and financial training as a means of improving management of the field offices (paragraph 21, GB.286/12/1).

Headquarters audits

Procurement at headquarters from regular budget funds

6. In 2002, the IAO had examined purchases made from a single supplier, acting upon a request from the Treasurer and Financial Comptroller who had received reports from the Chief of the Bureau of Internal Administration that procurement of office furniture had been made over the years apparently without regular price assessments. The audit found that the Office had already taken corrective action by organizing international competitive bidding and had stopped purchasing from the previous supplier. The IAO had recommended that regular market evaluations be carried out at least every two years, to provide transparency to the procurement process, and the PROCUREMENT section of the Bureau of Internal Administration should document the purchasing procedures, by means of a flow chart and short narratives, in order to provide a clearer picture of the procurement cycle and processing time and convey more clearly the importance to managers of early planning of needs and purchase requests.
7. The Bureau of Internal Administration has since instituted procedures for systematic price comparisons for both equipment and furniture requirements, and it plans to renew in 2004 an international invitation to tender for furniture to continue to ensure the most economical purchase. As regards the second audit recommendation, it has been reported that this is being implemented in conjunction with the Integrated Resource Information System (IRIS) project. The IAO will exercise in 2004 close follow-up on the effective implementation of both recommendations.
8. In 2003, the IAO reviewed all procurement and payment procedures for both equipment and furniture to evaluate the adequacy of the internal control system. This review encompassed all procurement in 2002-03, whereas the audit in 2002 had focused on 1999-2000 procurement of furniture from a sole supplier. The IAO found that the system of work processes and internal control needed strengthening at the initial stage of the procurement process; at the invoice approval stage; and at the payment authorization stage.
9. PROCUREMENT received an equipment purchase request (EPR) from requesting departments, but there was no check to ensure that the signature on the EPR was that of an official authorized to approve requisitions. PROCUREMENT did not receive or maintain a list of authorized signatories from departments to enable it to carry out this check. The IAO recommended that PROCUREMENT should maintain a list of signatories authorized to issue EPRs and introduce a procedure to check that only authorized officials have issued EPRs.
10. Prior to payment of a supplier's invoice, delivery of goods has to be confirmed. The official in the PROCUREMENT section of the Bureau of Internal Administration responsible for approving invoices for payment checked the delivery status in the ILO's inventory and stock system. If the system showed an item as delivered, the invoice was approved and sent to the ILO's Payment Authorization Section (PAIE) of the Financial Services Department for payment. However, the official assigned to record the delivery status of goods into the inventory and stock system was the same one (the Purchasing Officer) who initially prepared and dispatched the purchase orders. As such, the check on delivery of goods, prior to invoice approval, was not independent of the purchasing function and there was a risk that a purchase order could be established and the subsequent invoice paid without delivery

of goods taking place. The internal control system in place would make it difficult to detect the perpetration of such irregularities. The IAO recommended that an individual other than the Purchasing Officer notes the received status of purchase orders in the inventory and stock module and that the Purchase Officer's access right to amend the delivery status on the module be disabled.

11. ILO's Payment Authorization Section (PAIE) in the Financial Services Department used a computer-based application to process approved suppliers' invoices and other claims for payment. Five officials in the section had access rights to the application which allowed each to perform all three principal processing tasks to authorize a claim for payment, without an independent check. There was a risk that an irregular claim could be included in a payment batch and paid without being detected. The IAO recommended that PAIE ensure proper division of duties between those three tasks and that additional controls be included to ensure proper authorization of claims and that payment processing reports are signed and dated to evidence the check.

Field offices

12. During the 2002-03 biennium, the IAO visited nine field offices and has completed reporting on eight. The audit objectives were to evaluate the adequacy of the internal planning and monitoring with regard to operational activities of the offices; the effectiveness of their internal control systems; the efficiency of work procedures; the extent of compliance with established policies, regulations and rules; the reliability of the accounting data and other information; and the extent to which assets were accounted and safeguarded from loss.

Operational matters

Work planning and monitoring systems

13. The IAO reviewed work planning and monitoring processes in seven offices visited during the biennium. Three offices operated a satisfactory work planning and monitoring system to focus on and coordinate activities. Activities in the work programme were structured around the ILO's operational and strategic objectives and these offices also had systems in place for ongoing monitoring and updating of the workplan to reflect changing circumstances and conditions. The other four offices were not operating a formal work planning and monitoring system, although in two subregional offices, some of the ILO technical specialists had developed individual workplans.
14. The IAO recommended that these offices should improve their work planning and monitoring system for better direction, control and evaluation of performance towards achieving the ILO's operational and strategic objectives.

Seminars and workshops

15. All offices visited incurred substantial expenditure relating to conduct of seminars and workshops. The majority of offices had inadequate systems to monitor the results and impact of seminars to achieve the ILO's operational and strategic objectives, and track the timely reporting of expenditure. In a number of cases, the offices could not inform the IAO whether reports on the activities had been received and what follow-up had been made.
16. Cash advances made for seminars and workshops were generally properly accounted for on suspense accounts (transitory accounts) pending receipt of financial statements and supporting documents, except in two offices where advances were inappropriately accounted as they were posted directly to project accounts rather than to a suspense account. In one office, there were significant delays in receipt of financial statements and

supporting documents which resulted in many long-standing items remaining uncleared from suspense. Delays in clearing advances from suspense and inappropriate accounting impair proper financial reporting and budgetary control.

17. To improve management capacity for reporting, evaluation and future planning, the IAO recommended that the offices should institute a monitoring system to track, in respect of each workshop and seminar, details of actual costs, information on number and profile of participants, the due receipt and distribution of reports, follow-on activities, as well as a short description of the contribution of the activity to the operational and strategic objectives of the ILO.
18. To safeguard the ILO from risk of financial loss, the IAO recommended that further advances to organizers of workshops and seminars should be discontinued until they have provided financial reports of actual costs and supporting vouchers in respect of a past activity for which an advance was made. This should be formally made a standard rule through an Office circular.

Cost-sharing agreement

19. During an audit in 2003, the IAO found that an office had entered into a cost-sharing agreement in March 2002 with a private sector organization to run a series of training workshops, but it did not follow the established procedures for making such arrangements as set out in ILO Circular 5/64. The office ended up pre-financing the activities from regular budget resources in the sum of some US\$24,000. The organization's contribution had not been received at the time of reporting in December 2003 – 21 months later – although the office informed the IAO that it received an assurance from the organization that it would honour its part of the agreement.
20. The IAO recommended that the office should follow-up actively with the organization to receive its share of contribution and familiarize itself with the established rules and procedures prescribed in ILO Circular 5/64 to ensure non-repetition when negotiating and accepting a contribution from a third party to avoid risks of financial loss.

Contracting and procurement

21. An office entered into a US\$48,000 contract with a hotel for services to be provided to a Conference in April 2003 and it paid in advance a non-refundable deposit of some US\$24,000. The amount was far in excess of the delegated authority limit for advance payments, as set out in ILO Circular 5/67, and the office did not seek approval from the Treasurer as required by ILO's Financial Rules. There was also no evidence on file of a market survey to demonstrate that the office had obtained the best financial terms and conditions.
22. The activity was cancelled for circumstances beyond the ILO's control and the office could not obtain refund of the deposit due to the absence of a protection clause in the contract in the event of force majeure. The office informed the IAO that the supplier had agreed to apply the deposit against the costs of the activity which has been rescheduled to take place in 2004. It would appear that this was a verbal agreement.
23. The IAO stressed to the office the importance of complying with established rules to: (i) justify choice of suppliers and payment terms; (ii) obtain clearance for advances sought that exceed delegated authority limits; and (iii) obtain clearance from the Office of the Legal Adviser on such major contracts as safeguards against risks of losses, by ensuring, in particular, the inclusion of an appropriate protection clause to cover non-event in case of force majeure.

External collaboration services

24. All offices visited in Asia maintained an external collaboration contract database. The European and North American offices visited did not. All offices issued external collaboration contracts using the prescribed format.
25. In three offices, a significant number of external collaboration contracts were issued after work had commenced and in two of these offices, addenda to extend the period of contracts were issued well after the expiry date of the original contract. Both situations exposed the ILO to risk of disputes with the contractor and potential liabilities.
26. Three offices did not systematically obtain proper evidence of financial clearance from their respective finance units before signing contracts. Payments in one of these offices and in another two were not based on proper receiving reports in accordance with Financial Rule 6.60. Advance payments of fees were also made to external collaborators, which is contrary to prescribed instructions. In four offices, the date of birth of external collaborators was not consistently included on the contract, which is a requirement to demonstrate compliance with ILO's policy on hiring retirees. All these instances of non-compliance expose the ILO to risk of financial loss or not receiving value for money.
27. There is scope to improve the system of monitoring of external collaboration contracts across the board at both the local and regional level. An ILO Office in Asia, visited in 2002, improved its computerized database system to improve monitoring of performance. The database has been designed to provide financial and administrative data and information on quality of output and the contribution of the activity towards ILO objectives. The IAO recommends that the monitoring system developed in that office is used as a model for dissemination across the ILO to improve internal control over the use of external collaborators.

Missions

28. Travel costs also account for a significant amount of ILO offices' expenditure. The IAO reviewed planning and monitoring of missions in four of the offices visited. Only one prepared a consolidated mission plan for the year, but which did not provide cost estimates. Having in place a systematic approach to planning and costing missions would strengthen financial and budgetary control over mission credits and provide management information for the purposes of forecasting expenditure and help better coordinate activities between units and departments.
29. In three of the offices, mission reports were not systematically prepared by staff and those prepared were not centrally filed to enable access to other units for information sharing, follow-up action and reporting. Reporting of missions provides management with information on operations, outcomes and impact of activities, and can feed into workplans by identifying opportunities to exploit in the context of achieving the ILO's objectives.
30. The IAO recommended that the offices institute a mission planning and costing system, based on properly approved and revised workplans, to: (i) provide enhanced control over the use of mission credits available; (ii) improve expenditure forecast; and (iii) help identify possibilities of better coordination between them and other ILO units for more efficiency.
31. Internal Audit also recommended the use of a spreadsheet to monitor the missions approved and costs entailed, the due receipt and distribution of mission reports, the results of each mission, follow-on activities, and their contribution to the operational objectives of the ILO.

Technical cooperation projects

IPEC subcontracts

32. The majority of non-staff expenditure incurred on IPEC projects in one office related to subcontracts to implement action programmes, some US\$800,000 from January 2002 to June 2003, with a further US\$3 million in the pipeline. The IAO reviewed the systems of internal control over the selection process of implementing partners and subcontract payments as a means of securing satisfactory performance towards objectives and value for money.
33. The IPEC local Project Coordinator who identified action programmes submitted them to ILO headquarters with the proposals received from potential implementing partners for technical and administrative approval. There was no robust system of controls to demonstrate transparency in the selection of implementing partners and that the best service would be obtained at the best price. As part of the selection process, the action programmes approved had to go to the local Technical Committee, which comprised representatives from the Government and non-governmental organizations, and a local IPEC staff member. Having as a member of the Technical Committee an ILO official who is also in a position to identify action programmes and submit them for approval may lead to a situation of conflict of interest. Documentation of the selection process was also found to be inadequate with files lacking key documents concerning each stage of the selection process. The IAO recommended that IPEC, in coordination with the local ILO office, should designate as ILO representative on the Technical Committee an official who is not involved at the preliminary stage of identifying implementing partners and processing action programme proposals, and ensure each stage of the selection process is adequately documented on file to demonstrate transparency in the selection process.
34. All subcontracts include a clause that gives the ILO access rights to implementing partners' books of accounts. This access right was not exploited. The ILO recommended that IPEC, in coordination with the local ILO office, should draw up a work programme of visits to implementing partners for the purpose of inspecting their financial records and books of accounts and assessing their internal control on site over action programme payments.

Monitoring of technical cooperation budgets

35. In one office, the budget preparation, re-phasing and revision modules (BPS) and the budget management module (BMS) of the Financial Information System for External Offices (FISEXT) were not available to programming staff for budgetary control and impaired timely revision and re-phasing of decentralized technical cooperation budgets. The failure to ensure use and exploitation of these tools by programming staff has been noted by the IAO in many offices visited in the past, and entails further risks as regards the orderly execution of the projects through inadequate means available to them to monitor the budgets.
36. The IAO recommended proper assignment of these responsibilities to the concerned offices' programming staff (as provided in ILO instructions) by providing them with access to the BPS and BMS tools, and the necessary training as needed, to optimize efficiency and effectiveness of the internal control system over technical cooperation projects.

Financial matters

Cash management

37. In most offices visited the local, regional and headquarters panel of bank account signatories were not properly maintained up to date. The local panel often included staff

who had left the ILO or been transferred to another duty station, and headquarters and regional office records did not always reflect the current local panel of bank signatories. One office had moved to a system of sole signatory without proper authorization. This same office and another office also had cheques signed in blank, explaining that the panel of cheque signatories was inadequate, although they had the capacity to enlarge the panel to operate a dual signatory system. Not keeping the panel signatories up to date, operating a sole signatory system, and signing cheques in blank, are internal weaknesses that expose the Organization to risks of irregular payments and financial loss. The IAO recommends that regional offices should institute a monitoring system that would ensure that the panel of signatories is promptly updated on staff departure or transfer and are properly recorded on all files. They should also periodically review the adequacy of the signatory panels in all offices in their respective region to ensure the dual signatory system prevails at all times, and issue strong reminders that no cheques are to be signed in blank.

38. Three offices in two different regions had, in different periods, high cash balances on their bank accounts which were attributed to a lack of regular forecasting of cash expenditure as prescribed in the External Offices Manual. Besides the loss of interest income by holding these funds in a non-interest bearing account, there is a risk of financial loss associated with holding excessive cash at the country level. The IAO recommends that regional offices (and headquarters for European offices) should ensure the level of cash balances in offices under their supervision are not surplus to requirements for a given period to reduce risks of loss and allow for maximum benefits through short-term deposits of temporary surplus funds by the Treasury Operations Section of the Financial Services Department.
39. Two offices did not systematically invalidate invoices as paid, as required by established procedures, thus increasing the risk of double payment occurring. The IAO recommended that work methods in offices should ensure that all suppliers' claims are invalidated as paid on settlement and that the verifiers of accounts in regional offices improve their verification procedures to check consistency in the application of the Financial Rules.
40. Bank reconciliations were generally carried out promptly after the month-end closure. The office in Asia visited in 2001 that had not carried out bank reconciliations for a period of five months – see GB.286/PFA/3, paragraph 18 – took necessary corrective measures. Bank reconciliation statements prepared were not, however, systematically subjected to independent detailed verification; in one office, they have been concealing financial irregularities over a long period of time. The IAO recommends that regional offices should regularly check in detail the accuracy of bank reconciliations by comparing cash book entries against the bank statements' details and probe further in situations where the reconciliations show abnormal and/or long-standing reconciling items.

Suspense (transitory) account

41. In most of the ILO offices visited, suspense accounts contained many long-standing uncleared items. Much of the problem in clearing items could be traced to incorrect understanding, or incorrect matching, of reference numbers; inadequate follow-up on advances made to clear advances posted to the account; or lack of analysis of the underlying transaction to determine the appropriate clearance action. The situation of the suspense accounts has implications on financial reporting which in turn impairs budgetary control and the internal control weaknesses occasion additional risks in that irregularities can be perpetrated and remain undetected.
42. The IAO recommended that the workplan and work distribution of finance unit staff should provide for the monthly review and analysis of the suspense accounts, and that of programming staff should provide systematic follow-up on advances provided to partner organizations for activities such as seminars and workshops.

43. The IAO further recommends that the regional offices should enhance the verification of the status of the suspense accounts for the offices for which they have decentralized oversight responsibilities. Training they provide to finance staff regarding the suspense account should focus on the importance of proper and accurate general ledger (GL) referencing in accounting for individual advances and their subsequent adjustments, with the correct identification of the underlying transaction during the clearance stage.

Internal administration

Procurement of equipment and office supplies

44. In most offices visited, there was no evidence of price comparison and they did not systematically issue a signed purchase order to suppliers for major procurement of equipment, furniture and supplies. Proper receiving reports in accordance with Financial Rule 6.60 to support payment were also lacking. Compliance failure increases risks of perpetration of irregularities and financial loss.
45. The IAO recommended that the offices ensure due compliance with the financial rules to achieve transparency in the procurement process. The IAO provided them with its “best practices guidance” on how compliance can be achieved with organized work methods and demonstrated with a good filing system and proper supporting documentation. The IAO further recommends that regional offices ensure such adequate supporting documentation is received with the monthly accounts submitted by the offices to demonstrate compliance with the rules.

Travel

46. In five offices, the agreement with the appointed travel agents had not been submitted to PROCUREMENT and the Office of the Legal Adviser (JUR) for clearance of the terms and conditions of the contract.
47. The IAO recommended that ILO offices should initially use the standard agreement developed by headquarters as the basis for agreements with travel agents and clear the final version with JUR to ensure that all terms of the agreement are acceptable.

Custody of ILO assets

48. There was no evidence of regular physical checks against inventory records in some offices although it was reported that they were made. Physical checks by the IAO on a test basis gave, however, some assurance of the completeness of the inventory records.
49. The IAO recommended that physical checks be recorded promptly and that evidence of the control be systematically provided on the inventory records and files.

Personnel administration

50. In three offices, there were long delays in filling principal posts, which impacted on the effectiveness of internal control. The IAO recommended that competitions should be planned well in advance of departures on retirement or transfer.
51. In all offices visited, there were delays in preparation of appraisal reports for both local and Professional staff, and many remained long overdue at the time of the audits. Timely completion of performance appraisals for evaluation of staff performance is important to assess eligibility for retention and advancement, and to identify training needs. The IAO recommended that steps should be taken to clear backlogs and that a system be installed at levels of all offices to monitor due dates and fulfilment of this important evaluation process.

Investigations

52. One official made reports of non-performance against another official who counteracted with reports of mismanagement and eight cases of non-compliance with ILO rules and procedures for the personal benefit of the official who reported non-performance. There was no evidence of gain or fraud. As regards the other allegations, the investigation concluded that they arose on account of a severe breakdown in staff relationship and communication, but that some corrections were required to improve on management functions in that office. The Office took disciplinary measures against one staff member and provided the necessary instructions to the other to avoid a recurrence, including ensuring strict compliance with financial and administrative rules and procedures.
53. Investigation in another office on reports of cash misappropriation was confirmed. The financial irregularities were concealed by forging the financial records and manipulating the bank reconciliation statements. The loss was established at US\$10,000. The contract of the official involved in the fraudulent activities was terminated and action taken to recover the loss from terminal benefits.

Monitoring of follow-up action

54. Follow-up by the Chief Internal Auditor on implementation of audit recommendations is systematically and regularly made calling for evidence of implementation as considered necessary.
55. Regarding audits at headquarters, implementation reports have addressed most recommendations of prior years. As concerns outstanding key recommendations – most of which were being considered in conjunction with the implementation of the IRIS project – the Chief Internal Auditor was apprised of actions in progress and plans to complete implementation.
56. Regarding audit of field offices, all the significant recommendations addressed in 2001 and 2002 were reported as having been implemented, except in one office.
57. Regarding the two former investigation cases referred to in GB.286/PFA/3, one concerned irregularities in an implementing agency of a technical cooperation project, and the second involved an ILO official. Contract termination of the defaulting parties occurred in both cases. Regarding the first case, a schedule of repayments was agreed for the bulk of the losses incurred – which was being honoured – whilst negotiations remain in progress concerning the balance. Regarding the second case, the loss was being recovered from terminal benefits.
58. The circular on “Follow-up on recommendations of the Office of Internal Audit and Oversight” mentions the responsibility of “regional directors” – as the first line of control for their regions – to ensure there is prompt and effective implementation of audit recommendations addressed to ILO offices. The Chief Internal Auditor was pleased about the Treasurer meeting, in 2003, with the regional directors to emphasize to them the importance of their oversight and accountability responsibilities, and of his intentions to require periodic reporting from them on effective implementation of audit recommendations regarding field operations, and on consistency in their application region-wide. Indeed, such assurance can be provided through the independent regular regional verification that they make of the monthly financial reports and documentation they receive.