

## **Ninth question before the Committee**

### **Financial report and audited consolidated financial statements for the year ended 31 December 2018**

1. At its 335th bis Session (10 June 2019), the Governing Body took note of the External Auditor's report and decided to forward the financial statements for the year ended 31 December 2018 and the External Auditor's report thereon to the Conference for consideration and adoption. The appendix to this document contains the Governing Body's consideration of this matter.

### **Draft decision**

2. *The Committee decides to recommend to the Conference that it adopt the consolidated financial statements for the year ended 31 December 2018.*

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## Appendix

### Minutes of the Programme, Financial and Administrative Section of the Governing Body at its 335th bis Session (10 June 2019)

#### First item on the agenda

#### **Programme and Budget for 2018–19: Financial report and audited consolidated financial statements for the year ended 31 December 2018** ([GB.335bis/PFA/1](#) and [ILC.108/FIN](#))

1. The Programme, Financial and Administrative Section of the Governing Body met on 10 June 2019. It was chaired by the Chairperson of the Governing Body. Ms Menne and Mr Mdwaba were the Worker and Employer spokespersons, respectively.
2. *A representative of the Director-General* (Treasurer and Financial Comptroller) made brief introductory comments on the financial statements for the year ended 31 December 2018. He confirmed that the officers of the Board of the International Training Centre of the ILO in Turin had met on 28 May 2019 and approved the Centre's financial statements for the year ended 31 December 2018, which were consolidated with those of the ILO.
3. The general purpose financial statements (Statements I–IV), incorporating the full scope of ILO activities – those funded through assessed contributions, those funded from extrabudgetary sources and controlled entities, had been prepared in accordance with International Public Sector Accounting Standards (IPSAS) on a full accrual basis and reflected one year's financial activity. In contrast, Statement V-A provided an interim report of the financial performance of the Office during the first year of the 2018–19 biennium with respect to the regular budget only, prepared on a modified accrual basis in accordance with the provisions of the Financial Regulations. The table contained in Note 23 provided a reconciliation of the results presented under Statements II and V. The key reconciling items were the adjustment made for delays in the receipt of member State contributions and the reimbursement of the previous biennium's deficit, both of which were included only in the budgetary calculation of the surplus. In addition, the full accrual of entitlements, notably liability for after-service health insurance (ASHI), was brought to account in the IPSAS accounts but was not funded or included in the calculation of budgetary surplus or deficit.
4. Assessed contributions received from member States had been some US\$57 million higher than the budgeted income level for the year. Those contributions had included arrears from previous financial periods which had been applied to reimburse the last biennium's deficit of US\$69.6 million. As was common during the first year of a biennium, regular budget expenditure had been less than half the approved budget, resulting in a notional budget surplus of some US\$7 million, after reimbursing the previous biennium's deficit. The Office was confident that the increased expenditure rates in the second half of the biennium would result in the budget being fully delivered by the end of the financial period.
5. The value of the consolidated net assets of the Organization had improved over the past 12 months by some US\$40 million, mainly attributable to slight rises in international interest

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rates, which drove the actuarial estimates of the ASHI liability. As of 31 December 2018, the working capital and liquidity positions of the Organization remained strong.

6. The recommendations contained in the External Auditor's long-form report were broadly in line with initiatives and actions already being pursued by the Office, which had engaged extensively with the External Auditor throughout the audit process. The Office's summarized responses to the recommendations had been included in the body of the report.
7. Mr Aguinaldo, *Chairperson of the Commission on Audit of the Philippines*, presented his third report as External Auditor and the results of the audit of the Organization for the year ended 31 December 2018. The audit had included an assessment of the accounting principles used and the significant estimates made by management as well as an evaluation of the overall presentation of the financial statements. His staff had used a risk-based audit approach, based on an appropriate understanding of the ILO and its environment, including internal controls.
8. The audit had concluded that the financial statements presented fairly, in all material respects, the financial position of the ILO for the financial year ended 31 December 2018 and its financial performance, changes in net assets, cash flows, and comparison of budget and actual amounts, in accordance with IPSAS. Accounting policies had been applied on a basis consistent with that of the previous year. The transactions that had come to their notice or been tested during the audit were, in all significant respects, in accordance with the Financial Regulations and legislative authority. Based on those conclusions, he had issued an unmodified audit opinion.
9. His office had also reviewed the Staff Health Insurance Fund (SHIF), the status of the investigation of fraud cases, resource mobilization, programme reporting and monitoring, and the control environment in regional and country offices and made a number of recommendations, outlined in the report. In particular, after reviewing the SHIF, he noted that it would be cost-efficient to have clearly defined indicators or red flags corresponding to the different types of fraud schemes related to health insurance, in order to highlight potential fraudulent claims to be submitted for further investigation. With regard to fraud investigation, the ILO should put greater emphasis on the investigation of pending cases to send a clear message that fraud would not be tolerated, and further strengthen fraud controls. With regard to resource mobilization, the ILO's internal mechanisms needed to be enhanced by: deepening, expanding and diversifying partnerships and financing with other United Nations entities, international financial institutions and the private sector; optimizing the participation of field offices; and sharpening the corporate staff development strategy by aligning it to United Nations Reform and incorporating it into the 2020–25 Development Cooperation Strategy. With regard to programme implementation reporting and monitoring, he welcomed the establishment of a task force to facilitate results-based management, but urged the Organization to further enhance its Programme Management roadmap and strategies for reporting the status and progress of Country Programme Outcomes (CPOs) in the Outcome Coordinating Team (OAT) reports, as well as the results linking process of the CPOs to the 2018–19 programme and budget outcome indicators, and to improve its internal coordination during the review exercise. Lastly, following his review of the control environment in regional and country offices, he underlined the need for the ILO to assess the level of operational risk in its field offices and to implement strategic solutions to strengthen their supervisory and monitoring controls over critical processes and decisions.
10. Mr Harnischfeger, *Chairperson of the Independent Oversight Advisory Committee (IOAC)*, reported on the IOAC's review of the financial report and audited consolidated financial statements for the year ended 31 December 2018 and the report of the External Auditor. He supported the Office's efforts to issue the statement of internal control for the second year and noted the areas identified for improvement in 2018, as well as the progress made on

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issues identified in 2017. After discussions with the internal and external auditors as well as management, the process involved in producing the statement had been found to be sound and robust.

11. The financial statements for the year ended 31 December 2018 had been presented in accordance with IPSAS. The additional disclosures made in the notes reflected the requirements of the new IPSAS standards. However, although it was important to comply with standards, the resulting statements continued to be a challenge to understand.
12. He drew attention to the continuing unfunded ASHI liability. Although the amount had decreased as a result of increasing interest rates, the US\$1.6 billion obligation would have to be funded in the future.
13. He was pleased to note that the Office had again achieved an unmodified audit opinion on its consolidated financial statements and that the external audit plan had been fully executed. With regard to the specific issues the IOAC had addressed with the External Auditor, he said that the Committee was satisfied with the explanations of the major changes in assumptions used for the ASHI valuation. The Committee also supported the External Auditor's observations with regard to the backlog of investigations and would follow up on progress made in implementing his recommendations. Lastly, with regard to the SHIF, the Committee appreciated the recommendation to develop fraud indicators and red flags to facilitate consistency and efficiency, and also fully supported management's zero tolerance policy for fraud. A balance needed to be struck between those two objectives.
14. *The Worker spokesperson*, commenting on the report of the External Auditor, noted with satisfaction that the External Auditor had expressed an unmodified audit opinion on the 2018 consolidated financial statements in accordance with IPSAS.
15. Turning to the recommendations on SHIF and on the status of fraud case investigations, her group noted that some 42 per cent of fraud cases pertained to reimbursement claims in the SHIF, and welcomed the ILO response to the backlog of pending fraud cases of proposing an additional position in the Office of Internal Audit and Oversight (IAO) in the Programme and Budget for 2020–21. Addressing the backlog was necessary because the processing of claims was suspended until the results of the investigation were known, and thus any delay in the results of an investigation would be unhelpful to SHIF participants, if after investigation, a claim was proven not to be fraudulent.
16. With regard to resource mobilization, the group emphasized that the existing guidelines should be followed to ensure consistency with established decisions and procedures, both at headquarters and in the field, particularly in the case of the guidelines on public–private partnerships (PPPs). Recalling the March Governing Body debate on innovative finance at which a number of concerns had been expressed about PPP mechanisms, the group reiterated that the ILO should not engage with companies that failed to respect the values, principles and standards of the Organization and requested the Office to take that into account in developing its strategy of engagement.
17. The group further stressed that resource mobilization should support the achievement of all strategic objectives, and not be applied selectively at the moment of giving effect to the Decent Work Agenda.
18. The group noted the recommendations on programme implementation reporting with reference to the upcoming implementation report for 2018–19, as well as the follow-up by the Office to previous years' recommendations, particularly those concerning results based management in connection with the preparation of the 2020–21 Programme and Budget and its subsequent implementation report.

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19. In respect of reporting mechanisms, the group noted that better and more integrated tools were needed to follow up and register results throughout the biennium, as a number of templates and forms in current use, such as CPO strategy texts and budgets, were not always consistent and linked to initial plans. The results information would be more easily upheld if such forms were better linked and progress tracked in one document.
  20. Concerning the Implementation Report for 2016–17 and the upcoming report for 2018–19, the Workers' Group welcomed the focus on aggregated analysis of achievements by strategic objective, which enabled a better overview of the assistance provided by the Office in supporting constituents to achieve decent work.
  21. *The Employer spokesperson* thanked the External Auditor, the Chairperson of the IOAC, the Treasurer and Financial Comptroller and the Office for their statements.
  22. *Speaking on behalf of the group of industrialized market economy countries (IMEC)*, a Government representative of the United States of America noted that the auditor had issued an unmodified opinion for the ILO and the Turin Centre and that, while the organization had ended 2018 with a deficit and a negative asset balance, its financial position had improved compared with the previous year.
  23. IMEC appreciated the ILO's efforts devoted to internal control and risk management frameworks, which were very important to further improve the financial well-being of the organization, and also noted the practice of forward-purchasing foreign currencies, to help alleviate foreign exchange risks.
  24. The group further noted that the use of IPSAS increased the visibility of the long-term ASHI liability and was thus more straightforward to act upon.
  25. IMEC appreciated the Director-General's statement of internal control as a key accountability report. The discussion of significant internal control matters including follow-ups from the 2017 statement merited the attention of delegates.
  26. The group found the sections of the internal control statement concerned with the ILO operating environment and risk and control aspects to be somewhat generalized. Member States would benefit from more elaboration on the context specific to the ILO such as a description of risk appetite.
  27. IMEC appreciated that the 2018 internal letters of representation had revealed no major control weaknesses, but noted the need for improvements in terms of the institutionalization of Business Continuity Management strategy and tools, the strengthening of advance travel planning and the enhancement of workforce planning and skills development. It looked forward to receiving further information on progress in those areas.
  28. IMEC was encouraged by the Director-General's conclusion in the statement of internal control expressing his commitment to the continuous development.
  29. Regarding the External Auditor's report, IMEC applauded the unmodified audit opinion given to the ILO's financial statements for 2018. Accounting practices had been applied consistently from the previous year, and all transactions examined had been in accordance with the Financial Regulations and legislative authority of the ILO, according to the External Auditor.
  30. Concerning the key audit findings, IMEC urged the ILO to devise a timely strategy for investigating the large number of pending fraud cases, the majority of which originated in

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2018. Swift, careful handling of cases was critical to creating and maintaining a rule-of-law culture and proper stewardship of public funds.

31. IMEC would like to see greater effort devoted to field office controls and oversight. Clear definitions of fraud flags for further investigation by the IAO was needed immediately, since a lack of fraud indicators brought into question the ILO's anti-fraud culture. Procurement fraud cases need urgent attention, and field and regional offices must not become the weak link in the ILO's accountability and internal controls.
32. Concerning resource mobilization, appropriate and sustainable PPPs were needed, as well as the realization of increased civil society participation in the ILO's mandates. The External Auditor's recommendation to include performance outputs on resource mobilization for the staff involved with that function seem straightforward and reasonable.
33. The External Auditor had made a number of recommendations on results based management and IMEC looked forward to their implementation in the wider work of the results based management task force, especially in view of the upcoming discussion on a results based development cooperation strategy and with the 2030 Agenda and the Sustainable Development Goals in mind.
34. IMEC strongly believed that ethics rules, especially an update to the ILO's whistle-blower policy, the principles of conduct for staff, and the conflicts of interest policy, must be fully implemented in order to maintain faith in the ILO's commitment to maintaining the highest level of ethical standards in the world of work.
35. IMEC also looked forward to updates concerning results-based management and the recommendations of the External Auditor concerning an implementation monitoring system.
36. *The Treasurer and Financial Comptroller*, replying to comments made on travel, said that most official travel was planned in advance, but that there were inevitably exceptions to the quarterly plans due to last minute requests for assistance from constituents. Investigation of fraud cases were being expedited by the IAO through multiple measures including a clustering approach. Finally, the Office was actively implementing all the recommendations of the External Auditor.

## Decision

37. ***The Governing Body took note of the External Auditor's report and forwarded the consolidated financial statements for the year ended 31 December 2018 and the External Auditor's report thereon to the Conference for consideration and adoption.***

(GB.335bis/PFA/1, paragraph 4.)

Geneva, 10 June 2019