



THIRD ITEM ON THE AGENDA

**Report of the Chief Internal Auditor for  
the year ended 31 December 2004**

**Report of the Chief Internal Auditor on  
significant findings resulting from internal  
audit and investigation assignments  
undertaken in 2004**

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 2004 (see appendix).
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, 24 January 2005.

## Appendix

### Report of the Chief Internal Auditor on significant findings resulting from internal audit and investigation assignments undertaken in 2004

#### *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. 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.
3. The results of the IAO's audits undertaken in the field and at headquarters in 2004 indicate that there is no material weakness in the ILO's overall system of internal control.
4. Following a recommendation made by the External Auditor, the IAO completed and formally issued its Internal Audit Manual in 2004. The Manual describes the underlying principles, standards and code of ethics for the professional practice of internal auditing, and provides the IAO's audit process from planning and preparation to the performance of the audit, reporting of results, and follow-up of actions taken on recommendations. The Manual incorporates the new standards of the Institute of Internal Auditors (IIA) to provide guidance on all relevant aspects of the audit function. It contains a series of audit programmes, including on the audit of the ORACLE database and its applications. Its provisions and procedures are intended to supplement the experience, competencies, skills, and judgement of auditors in planning, conducting and reporting on audits. The Manual and its appendices are living documents and will be continuously updated, amended and enhanced.

5. The IAO devotes a fair amount of its resources to undertaking investigations into allegations of fraud or irregularities. The Chief Internal Auditor suggests that the Office should have a dedicated investigation unit for the reasons stated in the main part of this report.
6. The incumbent Chief Internal Auditor retires in April 2006. There is a need to begin identifying a potential successor to ensure continuity in the audit function and provide adequate time for a smooth handover.

### ***Audit at headquarters***

#### **Audit of the ILO Programme on HIV/AIDS and the World of Work**

7. The objectives of the audit were to determine the degree of compliance with procedures, rules and regulations; evaluate the accuracy and reliability of financial and management information; and evaluate the efficiency and effectiveness of operations.
8. The review of the operations shows that funding from the various donors and from the regular budget were efficiently used for the activities of the programme. There was a satisfactory internal control system over the programme's operations, and there was also satisfactory compliance with rules and regulations. To enhance its financial controls, the IAO recommended that the programme improve its follow-up system to ensure that expenditures at field level against financial authorizations are reported in the General Ledger on a timely basis.
9. The programme has achieved substantial outputs since its inception through its various activities, and the goals, activities and achievements of the programme are well represented in reports submitted to donors and various organs. The IAO recommended some modifications to the work planning and monitoring system of the programme to improve further its means to report results against plans, objectives, and targets.

### ***Audit of technical cooperation projects***

#### **Financial audit of a terminated project in Africa**

10. The objectives of this audit, which was conducted at the request of senior management, were to verify the correctness of income and expenditure reported in the project financial statement as at 31 December 2003; ascertain their completeness as well as their conformity with the project agreement, orders, contracts, other obligations, and with applicable ILO rules and regulations.
11. The project was launched in February 2001 and had an approved budget of US\$1,506,143. Project activities had ended at the end of June 2003. The project financial statement as at the end of December 2003 reported income of US\$1,265,237; expenditure of US\$1,176,263; and a credit balance on account of US\$88,974. The audit confirmed that the income and expenditure as stated conformed with the project agreement, orders, contracts, other obligations, and with applicable rules and regulations in all material respects. The expenditure was, however, not fully stated. Payments totalling US\$153,252, reported by UNDP (through the inter-office voucher (IOV) system) as made on behalf of the ILO had not been charged to the project: US\$88,180 had been booked to, and remained on, the Regional Office for Africa's IOV suspense account; and US\$65,072 had not been processed by the Regional Office. Taking these into account (and adding 13 per cent support costs), the net financial results were a cash deficit of US\$84,201, instead of the favourable cash credit balance of US\$88,974, the project financial statement depicted. There were also contingent liabilities of some US\$77,800 which, if they were to

materialize, would add to the deficit. On the basis of proposals made to a claimant regarding the principal contingent liability, and should the donor refuse to consider the ILO's request made to them to cover the deficit forecasted, the ILO would suffer losses of some US\$115,000. Inadequate control to ensure prompt receipt of IOVs and expenditure recording on the project account caused incomplete reporting of expenditure to the donor when applying for funds payable in instalments under the terms of the funding agreement, and this in turn caused the cash deficiency. The ILO should follow up with the donor to avoid incurring financial loss.

#### IOV and project suspense accounts

- 12.** Another project, also implemented in Africa, maintained an approved bank account and received funds from the Regional Office for its activities. The project periodically issued reports of receipts and payments and accounting information to the Regional Office for Africa which had the responsibility to process them and charge them to the project account on the appropriate budget line and against the approved obligations. The responsible technical unit at headquarters received a report from the Regional Office in Africa that some US\$180,000 of expenditure incurred were held in the suspense account, and needed to be charged to the project account. The Regional Office did not exercise supervision to ensure that proper accounting was made on receipt of the payment reports from the project. The gaps in expenditure reporting were not detected by the responsible technical unit staff due to inadequate monitoring of expenditure on their part against obligations recorded in the General Ledger, which could have prompted inquiries by them with the project staff at field level regarding the level of expenditures reported to the Regional Office for processing. The project staff did not receive financial status of the project accounts as stated in the General Ledger, and hence had themselves no means of comparing with their books of accounts the level of expenditure processed by the Regional Office, which could also have resulted in early inquiries and corrective action.
- 13.** Both internal audit and external audit have brought to management's attention the shortcomings on control exercised over recordings on the suspense accounts. External audit commented on the high level of suspense accounts (some US\$1,700,000) in its report to the Governing Body on the ILO's financial statements for the biennium 2002-03. Internal audit has also raised the issue of control over suspense accounts on several occasions. High values of expenditure held in suspense accounts, not promptly adjusted to charge the relevant project accounts, impacts negatively on financial reporting and budgetary control, and can result in financial loss to the Office, as illustrated in paragraph 11 above.
- 14.** The Office has taken some action to address the issue of suspense accounts. In June 2004, the Treasurer issued instructions to all ILO offices to improve monitoring and control of suspense accounts, and submit monthly returns of outstanding suspense accounts' items to their respective regional office. The regional offices, in turn, are required to submit quarterly reports to headquarters on suspense accounts' items not resolved and actions taken for redress. ILO offices and the Regional Offices were complying with the instructions, but other measures are required. Improved budgetary control for technical cooperation projects, including monitoring expenditure reported against financial obligations, should be achieved through appropriate work distribution in headquarters technical units (for non-decentralized projects) and in field offices (for decentralized projects). The secretarial and programming support staff of each unit or external office should be required to monitor expenditure incurred against payment authorizations issued, following up with the projects, as necessary, on long-standing obligations in the project accounts against which no expenditure is reported or appears to be incomplete. To implement this, training for secretarial and other support staff is required. The Chief

Internal Auditor has, in previous reports, referred to the need for training of administration staff, and managers also, regarding operational and financial controls.

***Audit of IPEC project “Elimination of the worst forms of child labour in selected informal/formal sectors in Bangladesh (BDG/00/050/USA)” and IPEC project “Combating child labour in the carpet industry in Pakistan – Phase II (PAK/02/50/USA)”***

15. The objectives of the audits were to assess the effectiveness and efficiency of the projects’ operations, including compliance with financial and administrative rules, regulations, policies and procedures; and to review progress reported towards the projects’ objectives.
16. The project in Bangladesh began in September 2000 (with a budget of US\$6,000,600 funded from USDOL) and is due to end on 30 June 2005. The project in Pakistan was launched in 1999 with funding from USDOL and the Pakistan Carpet Manufacturers and Exporters Association (PCMEA). A second phase of the Pakistan project was launched on 30 September 2002 with funding of US\$3,500,000 from USDOL and US\$900,000 from PCMEA. The planned project end date of this second phase in Pakistan is 1 September 2005. Both project documents were well designed, clearly setting out the objectives of the project, linking target groups, performance indicators and expected outputs to those objectives.
17. IPEC reported to the donor on a timely basis for both projects, providing comprehensive information on progress towards objectives, difficulties encountered and solutions to overcome the difficulties.
18. The main method of project delivery is through subcontracting action programmes to implementing partners. In Bangladesh, the implementing partner selection process was on the whole open, transparent, well documented, and demonstrated a thorough technical review. In Pakistan, the implementing partner selection process was satisfactory on the whole but has not been as thorough as in Bangladesh in the methodology used. IPEC is intending to develop guidelines concerning the implementing partner selection process, and the IAO recommended that elements of the selection process followed by the project in Bangladesh should be considered for inclusion in such guidelines.
19. One weakness found in the selection process in both countries was the lack of documentation regarding the methodology used to evaluate the reasonableness of the price quoted for the work to be done. Both projects had calculated an intervention cost per child which they used as a benchmark to evaluate price quoted, but the details of the calculation and evaluation were not properly documented on file. The IAO recommended that IPEC Geneva should provide guidance on methodology and minimum documentation required to demonstrate that a reasonable price has been obtained when selecting implementing partners.
20. The mid-term review of both projects was postponed and took place a few months later in each case. Both project documents provided for project evaluation at the end of the respective projects. The project documents emphasized the need for sustainability to achieve the project’s objectives. There is, however, no funding in the concerned project budgets to undertake a post-project evaluation to identify those interventions that have worked well and been sustained in the long term. Such post-project evaluations would assist the IPEC programme with its continuous work of identifying sustainable interventions, and provide more credible evidence of those that are reported as successful during implementation, and on completion, of project activities. The Office should seek to

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negotiate with donors a mechanism to provide funding for evaluation of major projects at some future date after completion of the projects.

21. Internal control over payments to implementing partners were good both at the respective project and ILO Office level although there was scope for more effective checks on supporting documentation, on random basis, and appropriate recommendations were made to achieve this.
22. The national steering committee plays an active role in the governance of IPEC projects, providing direction and guidance, as well as promoting sustainability and local ownership of child labour issues. To achieve these aims, they need to meet on a more frequent basis than was the case in both countries. The IAO recommends that ILO-IPEC (through the respective ILO offices as necessary) should liaise with the concerned ministry of labour to promote more periodic meetings of the committees with regard to their governance responsibilities and have the periodicity of the meetings stated in their terms of reference.

### ***Audit of field offices***

23. During 2004, the IAO audited the operations of the Regional Office for Latin America, two subregional offices, and three external offices. The audit objectives were to evaluate the adequacy of the internal planning and monitoring with regard to the operational activities of the offices; the effectiveness of their internal control system; 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.
24. The systems of internal control in each of the offices visited were satisfactory and operating well, but modifications to work processes and procedures and better division of duties were recommended to strengthen financial controls and reduce risks of perpetrating frauds.
25. Regarding work planning, the system in one office needed to be improved to ensure that its workplan activities are aligned with the ILO's strategic and operational objectives, and provide required inputs, planned outcomes, timeframe for execution, and responsible official(s). An effective planning and monitoring system is a necessity to ensure realistic outputs and targets are set by matching available resources to planned activities, and to measure progress towards meeting the ILO's strategic and operational objectives. The work planning system implemented at unit level should complement the newly implemented ILO Strategic Management Module to facilitate the reporting of results.
26. The ILO's procurement rules had been properly complied with in the tendering and selection process regarding the contract for the construction of the building for the Regional Office for Latin America. The payments to the contractor were in accordance with the terms of the contract. Additional work was carried out on the building to install air-conditioning, and on its sixth floor to accommodate IPEC staff; the related costs were charged to the regular budget of the Latin America region.
27. The roof of the auditorium of the ILO building in Islamabad is in need of repairs. It has developed major leakage which causes flooding down one side of the interior every time it rains, and damage to part of the fixtures and fittings located there. The Internal Administration Bureau commissioned a firm of civil engineers based in Geneva to inspect the roof and assess the damage. The civil engineers reported in late December 2003 that repairs were required to prevent further degradation to the parts damaged and avoid substantial renovation works in the future. The ILO obtained cost estimates of Sw.frs.219,900 to change completely the roofing, or Sw.frs.100,900 for roof waterproofing

works only, with the materials coming from Europe. The former option would provide a more permanent solution to the problem. The IAO recommended that the Office should consult with the Internal Administration Bureau and the Treasurer for a decision regarding the works needed and funding arrangements.

28. The auditorium of the ILO Office in Islamabad was underutilized. It has been used at times for UN or government events, free of charge. The Office should formulate a policy and provide guidelines on the use of the auditorium.
29. There was no costed rolling maintenance plan for the two above-stated buildings, equipment and fixtures. The Internal Administration Bureau should ensure a costed rolling maintenance plan is developed for each ILO-owned premises and funding is earmarked for the purpose in the regular budget.

### ***The Integrated Resources Information System (IRIS)***

30. The development and implementation of the Integrated Resources Information System will bring changes in work procedures and controls. The IAO will be adapting its audit methodology and approach to address the changes and risks in the control environment of the Office. To obtain a broad overview of these changes, all IAO staff attended the information sessions delivered by the IRIS team on each of IRIS functionalities. As part of the ongoing process of equipping IAO staff with the necessary skills to work effectively in the ORACLE environment, they have attended two structured training courses, one on “Securing and controlling ORACLE client/server databases”, and the other on the “Audit and security of ORACLE financials”. IAO staff will also be provided with appropriate training by the IRIS team to facilitate audit inquiries and examination through the ORACLE database.
31. The IAO issued to the IRIS Executive Project Sponsor a questionnaire covering staffing, organization and security of the ORACLE database and applications. The questionnaire’s main purpose was to: (i) assist management by providing them with a comprehensive check list of high-risk areas to ensure they have been well addressed; and (ii) obtain pertinent information on the security and internal control systems that would feed into post-implementation audit reviews.

### ***International Training Centre of the ILO***

32. The audit objectives were to review the adequacy of cash management at the International Training Centre (ITC) and assess the effectiveness and efficiency with which ITC’s management matches the inflow and outflow of cash. The review encompassed cash management systems in force, with focus on banking arrangements; invoicing; income/debt collection; payments to suppliers; and investments. The audit concluded that the ITC manages cash inflows and outflows quite satisfactorily but has the potential to improve the rate of cash inflows through a combination of measures.
33. Within the framework of the Agreement signed on 13 December 1983 between the Italian Government and the ILO regarding the ITC, the Italian Government had expressed the wish that the ILO would progressively equalize its contribution to the level of the Italian Government’s contribution. In US dollar terms, the ILO’s contribution represented on average over the last three biennia some 38 per cent of the Italian Government’s contribution, but nearly 40 per cent based on actual remittances, due to exchange rate fluctuations.
34. The Italian Government’s voluntary contribution is payable in two instalments on 1 January and 30 June as per the Agreement signed between the Italian Government and

the ILO. It accounted for approximately 70 per cent of all voluntary contributions to the ITC. The Italian Government's contribution towards training activities accounted for approximately 33 per cent of income earned from training activities. Payment of the second instalment of the voluntary contribution and the payment of the total contribution towards training activities has in recent years been made towards the year end. This has had an impact on the cash flow of the Centre.

35. The invoicing policy of the Centre and its management of accounts receivable also impacted on the ITC's cash flow. It took on average 123 days from completion of a training activity to raise an invoice; and finalizing the Notice of Agreed Activity (NOAA), which is part of the process in raising an invoice, took on average 80 days. ITC did not always request an advance payment when entering into large value contracts with sponsors. Whilst the level of the ITC's accounts receivable has decreased substantially in the period 1998-2002 as a percentage of income (from 55.60 per cent in 1998 to 44.00 per cent in 2002), it still remained high. At the time of the audit, there were unpaid invoices totalling some US\$4,575,000 of which US\$825,500 (18.00 per cent) were over one year old.
36. To improve its cash flow and cash management system, the IAO recommended that the ITC consider organizational and workflow changes to address the continual delays in raising an invoice, and it should seek to obtain advances from sponsors as a matter of policy with any exceptions being justified in writing and waived only on the authority of the Treasurer of the Centre. The ITC also needed to take a more aggressive and structured approach towards follow-up of debtors.
37. The Centre, on the basis of its practices, and taking into account the recommendations made by the IAO, should document its cash management policy and procedures to ensure continuity of practices and controls on staff turnover.
38. ITC prepares its budget of programmed activities on an annual basis in US dollars. ITC's financial statements are also stated in US dollars. Major suppliers, and staff salaries, are paid in euros. Receipt of the Italian voluntary and training contribution is in euros, and the ILO's contribution is in US dollars (when paid in cash). Preparing budgets in one currency when the majority of financial transactions occur in another can distort reporting of actual income/expenditure against budget. Reporting in a different currency to the one principally used to carry out financial transactions also exposes the ITC to exchange risk. As the euro is the currency ITC mainly uses to conduct its economic activity, the IAO recommended that the Centre should investigate the possibility of budgeting and reporting in euros.

## ***Investigations***

39. During 2004, the IAO examined three cases of alleged irregularities. One investigation was commissioned to an outside firm of auditors and their findings and conclusions did not support the allegations. The IAO undertook some preliminary investigations and it also contributed to the terms of reference for the outsourced investigation. The IAO's investigation findings in one case alleging an official's non-compliance with the ILO's rules and instructions when submitting a claim on the Office was communicated to the Treasurer and Financial Comptroller for appropriate action. The third investigation, on the basis of allegations of financial irregularities on a project in Africa, is ongoing.

## ***Follow-up on internal audit recommendations***

40. In GB.289/PFA/6 (March 2004), the Office reported that it was committed to implementing the Chief Internal Auditor's recommendation to compile information for missions, seminars, and external collaborators to enhance reporting capacities as regards

the contributions they make to the operational and strategic objectives of the ILO. The Office had intended to implement the recommendations in conjunction with the development of the Integrated Resources Information System (IRIS). The IRIS team informed the IAO they would add the development of this reporting to their work programme in 2005. Most information and data required to populate the reports recommended would be captured by the ORACLE database.

41. The Chief Internal Auditor also recommended that the Office enhances its briefing and orientation of staff with management responsibilities regarding operational and financial controls. As stated in GB.291/PFA/17 (November 2004), the Office has developed a management and leadership development programme (MLDP), financed from the 2000-01 cash surplus. The Office completed by end of 2004 the first phase and second phase of the MLDP (an individual development assessment programme and three four-day workshops) for a total of 56 participants at the P.5 and D.1 level, coming from headquarters and some field offices. In the third and last phase, the Office plans to complete, by end 2005, 24 self-directed learning modules to deliver to the same participants. Participants will be expected to select six of the optional modules in addition to the four required modules. The modules include one on budget and financial management, and the IAO recommends that this should be made available to all staff with financial management and monitoring functions.
42. The responses to implementation of the IAO's recommendations by headquarters units and field offices have on the whole been good. The offices/units audited have provided comprehensive reports of action taken, with few instances where full reporting on some recommendations needs to be completed. The IAO continues to provide guidance and assistance to management, as considered necessary, to give effect to the recommendations.
43. The Treasurer and Financial Comptroller now requires field offices to submit their implementation reports through the concerned regional offices, and the latter to provide their evaluation of effective implementation of the audit recommendations and of actions they have taken to avoid recurrence in their respective region of the systemic weaknesses previously reported in GB.289/PFA/6 (March 2004). The IAO has welcomed this initiative which serves to emphasize the regional offices' responsibilities to oversee that the system of internal control at regional level operates continually in a satisfactory manner. The Office still needs to implement a mechanism to monitor effective reporting in accordance with the Treasurer's instructions.

### ***Dedicated investigation unit***

44. One of the primary functions of the IAO is oversight. Exercising this oversight function requires continual review of the control environment of the Organization. Weaknesses in the control environment expose the Office to risks of perpetrating fraud and corruption. In order to deter such actions, the strengthening of the control environment is desirable. Having a dedicated investigation capability within the IAO, with adequate staffing and operational resources, would assist in strengthening the general control environment of the ILO.
45. Large organizations in the UN system have a dedicated unit, with the specialist skills required in their staffing complement, to conduct investigations into alleged misconduct in accordance with internationally recognized investigative protocols and standards, giving careful consideration of due process requirements. A dedicated investigation unit promotes consistency and rigour, and its existence would reassure staff, constituents and donors alike of the seriousness with which the International Labour Office approaches its investigations into alleged misconduct, fraud or corruption.

- 46.** Over the recent years, the IAO has undertaken a certain number of investigations, but always in response to allegations of fraud or misconduct. They have had, and will continue to have, an impact on the IAO's approved audit workplan, causing planned audits to be delayed or even cancelled, or resulting in delayed reporting for audits undertaken. Continued disruption to planned audits would reduce the IAO's capacity to fulfil adequately its internal audit mandate of providing assurance to management on adequacy and effectiveness of internal controls in place.
- 47.** The main benefits of having a dedicated investigation unit would be that allegations of staff misconduct, fraud or corruption would be investigated in a timely manner.
- 48.** A dedicated investigation unit would further: (i) act as a deterrent to would-be perpetrators of fraud or irregularities and demonstrate the commitment of the ILO to combat fraud and corruption; (ii) send a clear message to all employees and third parties that a "zero tolerance" approach to fraud and corruption is being followed; (iii) ensure that there is appropriate coverage of mainstream audit assurance work (this is important given the Organization's responsibility to demonstrate sound governance and the emphasis donors place on good governance); (iv) allow investigation into cases of presumptive or suspected fraud as well; and (v) allow the Organization to move towards proactive investigation where the potential for identifying and correcting recurring problems would be greater.