International Labour Organization

Report of the External Auditor

Audit of the financial statements of the International Labour Organization for the 71st financial period (2008–09)

International Labour Office Geneva

ISBN 978-92-2-121914-9 (Print)
ISBN 978-92-2-121915-6 (Web pdf)
ISSN 0074-6681

First published 2010

Formatted by TTE: reference Confrep/ILC99(2010)/Audited accounts/2010-05-0148-1-En.doc
Printed by the International Labour Office, Geneva, Switzerland

Auditor General of Canada
Vérificatrice générale du Canada

To the Governing Body of the International Labour Organization

On 26 March 2007, at its 298th Session, the Governing Body of the International Labour Organization (ILO) appointed the Auditor General of Canada as the external auditor for a period of four years.

The audit of the ILO's financial statements for 2008–09 represents our first audit as external auditor. The following report contains the results of the audit and includes observations arising from the audit of the 2008–09 biennium financial statements. We would be pleased to elaborate on any of these points during the Governing Body meeting in June 2010.

We wish to express our appreciation to the Director General, the Executive Director, Management and Administration Sector, the Treasurer and Financial Comptroller and their staff for the cooperation and assistance received during the audit. We also wish to express our appreciation to the Governing Body and Conference of the ILO for the support and interest shown in the work of our Office.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada
External Auditor

Ottawa, Canada
7 May 2010

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Main points

We expressed an unqualified audit opinion on the International Labour Organization's financial statements. We concluded that they present fairly, in all material respects, the ILO's financial position as at 31 December 2009, its financial performance, cash flows, and the comparison of budget to actual amounts for the 24-month period then ended in accordance with the United Nations System Accounting Standards as set out in Note 2 to the financial statements. We concluded that these accounting policies were applied on a basis consistent with that of the preceding period, after giving retroactive effect to the changes as explained in Note 4. We also concluded that the transactions of the ILO that have come to our notice or that have been tested as part of the audit, have, in all significant respects, been in accordance with the Financial Regulations and legislative authority of the ILO.

Management has made significant progress in improving the overall financial statement presentation in the current biennium. The change in financial statement format is consistent with the reporting framework recommended by the International Public Sector Accounting Standards Board and allows the ILO to continue with the planned implementation of these accounting standards over the next few years. As part of our first financial audit of the ILO, we examined the implementation of four International Public Sector Accounting Standards (IPSAS) adopted by the ILO in these financial statements. We are satisfied that they have been appropriately implemented.

The United Nations Task Force on Accounting Standards has recommended that the International Public Sector Accounting Standards be adopted as the accounting framework for all organizations within the United Nations. The move from the United Nations System Accounting Standards (UNSAS) to IPSAS will result in a fundamental shift in reporting. The ILO is planning to present financial statements that are fully compliant with IPSAS by 2012. This will be a very challenging task that we will continue to monitor and report to the Governing Body.

As part of the financial audit, we also identified opportunities to strengthen the financial controls of the ILO. Our observations on financial controls will be included in a management letter that will be issued to the management of the ILO in the coming months.

About the Office of the Auditor General of Canada

1. The Office of the Auditor General of Canada (OAG) is an independent audit office and a world leader in legislative and environmental auditing. We promote good financial and environmental management and sustainable development.

2. The OAG is widely involved in the activities of the Canadian and as well as the international audit and accountancy profession. In Canada, the OAG is involved in many professional organizations, notably The Canadian Institute of Chartered Accountants, which sets accounting and assurance standards. Internationally, the Auditor General is a member of the International Public Sector Accounting Standards Board, and the OAG has more than 50 years of experience collaborating with international partners in developing professional standards, building capacity, sharing knowledge, and conducting audits of international institutions.

Our mandate

3. The Auditor General of Canada was appointed external auditor of the ILO in March 2007. The ILO Financial Regulations, chapter IX and the appendix, elaborate on the terms of reference governing the external audit. The regulations require that the external auditor report to the Governing Body on the audit of the financial statements of the ILO and on other such matters that should be brought to its attention.

Scope and objectives of the audit

4. An audit is an independent examination of evidence supporting the amounts and disclosures in the financial statements. It also includes an assessment of the ILO's compliance with significant authority instruments and considers whether, during the course of our examination, we have become aware of any other matters that, in our opinion, should be brought to the attention of the Governing Body.

   The objectives of the audit were to provide an independent opinion on whether

   - the financial statements have been fairly presented, in all material respects, in accordance with the United Nations System Accounting Standards;
   - the accounting policies set out in Note 2 to the financial statements have been applied on a basis consistent with that of the preceding period; and

- the transactions coming to our notice or that we have tested as part of the audit were, in all significant respects, in accordance with the Financial Regulations and legislative authority.

Audit approach and auditor's responsibilities

5. We conducted our audit in accordance with the International Standards on Auditing. These standards require that we plan and perform an audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An 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.

6. When planning the audit, we acquired a sound understanding of the ILO and its environment, the risks it faces, how the ILO manages those risks, and its overall control environment. This understanding is based primarily on interviews with senior management and our audit knowledge of the ILO and its environment, including its internal controls. We obtained such an understanding in order to plan our audit and also to determine the nature, timing, and extent of audit procedures to be performed.

7. The auditor's responsibility is to express an opinion on the financial statements based on an audit thereof. An audit is performed to obtain reasonable but not absolute assurance as to whether the financial statements are free of material misstatement, including those caused by fraud or error.

8. A detailed report summarizing the business risks identified and other audit risks and our planned procedures to address each of these risks was prepared and discussed with ILO management. We identified the key risks that could have an impact on the achievement of the fair presentation of the results of the ILO's operations and obtained an understanding of those risks that had implications for the financial statements. We focused on areas with a higher risk of a material error or non-compliance with significant authority instruments, based on our understanding of the ILO and its activities.

9. The audit plan was presented to ILO management and the Independent Oversight Advisory Committee at a meeting in February 2009 in order to ensure that we had identified those areas of significance and that our evaluation of the current operating environment of the ILO was complete.

Audit results

10. We issued an unqualified audit opinion on the ILO's 2008–09 financial statements. We concluded that the financial statements present fairly, in all material respects, the financial position of the ILO as at 31 December 2009, and its financial performance, cash flows, and comparison of budget and actual amounts for the 24-month period then ended in accordance with the United Nations System Accounting Standards as set out in Note 2 to the financial statements.

11. We have included an Emphasis of Matter paragraph in the Opinion. An Emphasis of Matter is included in an external auditor's opinion when in the judgment of the auditor, it is necessary to do so as the matter is of such importance that it is fundamental to the users' understanding of the financial statements.

12. The Emphasis of Matter paragraph we have included draws attention to Note 5 to the financial statements, which describes the adjustments made to the 2006–07 financial statement figures relating to the accounting for buildings, derivatives, investments, and voluntary contributions. In our view, these prior period adjustments were properly accounted for and disclosed in the note to the financial statements.

13. As required by the Financial Regulations of the ILO, we concluded that the accounting policies were applied on a basis consistent with that of the preceding period, after giving retroactive effect to the changes in accounting policies made in 2008–09, which are explained in Note 4 to the financial statements.

14. We also concluded that the transactions of the ILO that have come to our notice during our audit or that have been tested as part of the audit of the financial statements have, in all significant respects, been in accordance with the Financial Regulations and legislative authority of the ILO.

15. Our Independent Auditor's Report was modified to indicate that the 2006–07 financial statements were audited by the National Audit Office of the United Kingdom whose report expressed an unqualified opinion on those financial statements.

16. We are charged with reporting any disagreements with management over auditing, accounting, or disclosing matters that could, individually or in aggregate, significantly affect the financial statements or our independent auditor's report. We are also obliged to report whether we resolved any disagreements satisfactorily. There are no unresolved matters to report.

17. We are required to report on fraud and illegal acts involving senior management, as well as fraud and illegal acts (whether by senior management or other employees) that cause a more-than-trivial misstatement of the financial statements. We emphasize

that it is management's responsibility to establish a control environment and maintain policies and procedures to help ensure the orderly and efficient conduct of the ILO's business. Our audit procedures did not identify any matters related to fraud and/or error that should be brought to the attention of management or the Governing Body.

18. Preparing the financial statements requires the use of accounting estimates. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's expectations. The most significant estimates include employee benefit liabilities, including the after service health insurance, the proportion of the Staff Health Insurance Fund investments held on behalf of International Telecommunications Union (ITU), and the provision for assessed contributions receivable. When considering the reasonableness of these estimates, we reviewed the supporting working papers and documentation, and performed recalculations and other such tests and procedures as we considered necessary in the circumstances. We accept management's judgments and find them consistent with the corroborating evidence.

Audit completion

19. This was the OAG's first audit of the ILO's financial statements. Accordingly, we documented the ILO financial reporting framework and its overall control environment. As a result, the transition to a new external auditor resulted in many discussions with ILO's Finance management. We acknowledge the investment of time afforded to us by the ILO and wish to express our appreciation for the continued cooperation throughout the audit.

Detailed report on audit results

20. As required by International Standards on Auditing and the ILO Regulations, we report to those charged with governance of the organization whose financial statements are being audited. In particular, we report on significant changes in accounting policies, accounting estimates and financial statement disclosures, and other matters that in the auditor's judgment are significant to the oversight of the financial reporting process. We have prepared a detailed report for the Director General and we will discuss this report with the Independent Oversight Advisory Committee. Significant issues identified during our audit and their resolution are presented below.

21. During the audit, we also identified opportunities to improve the ILO's financial controls. These opportunities have been discussed with the Treasurer and Financial Comptroller and his staff and will be included in a management letter that summarizes our observations and makes recommendations to address our findings.

Implementation of IPSAS at the ILO—progress to date

22. In its November 2009 Status report on implementation of International Public Sector Accounting Standards (IPSAS) to the Governing Body, the ILO reported that for the 2008–09 biennium financial statements, it would have the following in place:

    - the balance sheet accounting for land and buildings, after service health insurance and other staff liabilities;
    - disclosure of related party transactions;
    - extra-budgetary expenditure recognized on an accrual basis for financial reporting purposes;
    - financial statements amended to IPSAS format; and
    - revised disclosure of any financial instruments (this mainly relates to currency hedging).

23. One concern related to a phased implementation of IPSAS is that the financial statements would fail to present the transactions and events of a particular biennium in a true and fair manner. For example, the Statement of Financial Position could be distorted if liabilities such as employee benefits were added without assets such as land and buildings being added in the same period. We are pleased to note that the ILO evaluated this issue and ensured that balanced reporting continued to be achieved. We are required by our auditing standards to evaluate the overall accounting framework adopted by an organization. We are satisfied that the financial statements adopted for 2008–09 showed a true and fair presentation of the ILO's activities in accordance with the United Nations System Accounting Standards (UNSAS) and that the financial statements, including the accounting policies , are relevant, reliable, and understandable.

24. In the 2008–09 financial statements presented to the Committee, the ILO adopted IPSAS 25—Employee Benefits. Employee Benefit and other staff liabilities are now recorded in the financial statements. This change resulted in an increase in liabilities of $601 million. In the past, the ILO disclosed in a note to the financial statements the estimated liability related to after service medical benefits, repatriation grants, and travel and accumulated leave upon separation.

25. Another significant change made by the ILO in its 2008–09 financial statements was the adoption of the new accounting policy whereby all land and buildings would be recorded at fair value instead of at historical cost at the end of the reporting period. This change resulted in an increase to the recorded amount of land and buildings of $373.5 million on the Statement of Financial Position. The change in accounting

policy has been implemented in compliance with UNSAS and does not constitute the adoption of a new IPSAS.

26. The ILO adopted the IPSAS 19 on Provision, Contingent Liabilities and Contingent Assets to reflect liabilities in the Statement of Financial Position. The ILO recorded a provision for Contingent Liabilities for the first time in its 2008–09 financial statements that resulted in a liability of $300,000.

27. The ILO did not account for extra-budgetary revenues and extra-budgetary expenditure (other than that related to salaries and benefits) on a full accrual basis in the financial statements as planned because it does not yet have the systems and procedures fully in place to capture all the necessary information.

28. Investments and derivatives held by the ILO are now presented at fair value in its financial statements. It also records the variances in the fair value from one period to another as a gain/loss on investments. In the past, ILO recorded its investments at cost and disclosed their fair value in a note. In adopting this new accounting policy, the ILO provides the readers of its financial statements with more up-to-date and better information on its investments and derivatives.

29. Additionally, as required by IPSAS 20, note disclosure for related party transactions was added. Finally, IPSAS 24 on Presentation of Budget Information in Financial Statements has been completed as required in a Statement and note to the financial statements. We are satisfied that the IPSAS standards adopted during the period were in accordance with the requirements of the standards and that the changes were properly reflected in the financial statements.

Change in the presentation of the ILO's financial statements

30. In 2008–09, the ILO adopted a new presentation format for its financial statements. We support this new format as it provides the readers of the financial statements with better information on the overall results of operations that the ILO is responsible for administering. The new format presents the assets and liabilities, revenues, and expenses in a different manner than in the past and it also provides a significant amount of additional financial information in the notes. The new format is in line with the format recommended by IPSAS.

31. The ILO now presents a Statement of Financial Position, a Statement of Financial Performance, a Statement of Changes in Net Assets, a Statement of Cash Flow, and a Statement of Comparison of Budget and Actual Amounts. The ILO no longer discloses on these statements any detailed information on individual funds or reserves. This information is now found in the accompanying notes to the financial statements. As part of this change in its 2008–09 financial statements, the 2006–07 comparatives have been reclassified to reflect the same presentation.

32. The change in format is a positive step toward providing readers of the financial statements with additional financial information in a clearer and easier format to understand. We encourage the ILO to continue with this new presentation and additional disclosure as it moves to being fully compliant with IPSAS by 2012.

Change in estimating the doubtful collection of assessed contributions in 2008–09

33. Prior to 2008–09, the provision recorded against assessed contributions receivable was set at 100 percent in accordance with the Financial Regulations, Article 18.1. In 2008–09, in order to align its accounting policy to a standard based more on IPSAS, the ILO decided to estimate a provision for the purposes of financial reporting that focused more on the accounts in arrears that are doubtful in their collection. The provision now includes assessed contributions that are more than two years delinquent and for which the right to vote has been lost, as per the ILO Constitution, and for which the member State has not negotiated any long-term financial arrangements with the Governing Body. The provision also includes amounts receivable from former member states. The long-term financial arrangements are also discounted and this is included in the provision. We agree with the new methodology adopted by the ILO, which is more in line with generally accepted accounting principles.

Prior period adjustments

34. During the audit, adjustments were identified that had an impact on the prior period's financial statements. The ILO adjusted the comparative financial results for 2006–07 as required by UNSAS. These included

- the reduction of historical cost of the headquarters building by $200,000. Under UNSAS, non monetary items (such as buildings) are carried at historical cost with no adjustment in subsequent periods. Previously, the historical cost had been revalued to the current UN exchange rate at the end of each reporting period;

- the inclusion of the value of the forward purchase agreements (liability of $11.9 million as at the 31 December 2007) held by the ILO to finance the US dollar requirements of its Regular Budget and its US dollar exposure of the Staff Health Insurance Fund. The purpose of these forward purchase agreements are to lock in the exchange rate for various expenses in US currency to be incurred over the next 90 days;

- the increase in revenues and a transfer between two liability accounts—Other current liabilities and Due to donors (US $5.9 million) in the 2006–07 financial statement to reflect contributions received in 2007 that should have been recorded as revenues, rather than deferred revenues; and

- the adjustments made to Staff Health Insurance Fund investments to reflect the appropriate conversion of the currencies to US dollars.

We are satisfied that the ILO's financial statements have been properly restated to reflect the prior period adjustments noted above.

Related audit matters

International Public Sector Accounting Standards (IPSAS)

35. The accounting standards presently used by the ILO to prepare its financial statements are based on the United Nations System Accounting Standards (UNSAS). At the meeting of the United Nations System of High Level Committee on Management on 21 November 2005, the Task Force on Accounting Standards recommended that the United Nations System organizations adopt International Public Sector Accounting Standards (IPSAS) as its accounting framework, with all organizations adopting IPSAS effective no later than reporting periods beginning on or after 1 January 2010. In June 2006, the United Nations General Assembly approved the adoption of IPSAS as the new accounting standards for the United Nations System. At its February 2010 session, the High Level Committee on Management subsequently removed this target date to provide more flexibility for organizations to comply with the new standards.

36. We strongly support the United Nations System's move to adopt IPSAS. This change in accounting framework will improve the quality, comparability, and credibility of the United Nations System financial reporting, resulting in improvements in accountability, transparency, and governance.

37. In November 2006, the Governing Body of the ILO approved the adoption of IPSAS for the financial period beginning 2010. In November 2009, the Governing Body noted the revised implementation plan whereby the ILO should be compliant with all except 7 of the 26 IPSAS by the end of 2010 and should be able to comply fully with all standards by the end of 2012.

38. The move from UNSAS to IPSAS will require a fundamental shift in accounting framework, from one that is primarily budget-based to one that is accrual-based. The Task Force on Accounting Standards describes the key accounting implications of the adoption of IPSAS on the United Nations System's of accounting, as follows:

- full recognition of liabilities for employee benefits such as after-service-health insurance, annual leave, and repatriation grants;

- recognition and depreciation of all capital assets such as buildings, vehicles, furniture, and equipment;

- recognition of expenses on the basis of goods and services received (the delivery principle); and

- consolidation of activities or entities not currently included in organizations' financial statements.

39. This fundamental shift in framework will not only have an impact on accounting, but could also ultimately have an impact on budgeting, funding, and organizational management. The adoption of IPSAS is a major undertaking that requires changes to the Financial Regulations and Rules, significant and ongoing project management, staff training in the field and at headquarters, the development of accounting policies and procedures, and investment in systems to capture required information.

Implementation of IPSAS—governance and next steps

40. The governance structure of the IPSAS project at the ILO is currently as follows: Implementation of the project is led by an informal group made up of the Treasurer and Financial Comptroller as well as three finance management staff members, all of whom still carry out their normal responsibilities, as well as one part-time consultant.

41. Best practices would normally include the following:

    - a project champion that has the required authority to ensure that adequate resources are allocated to the project and that the implementation occurs within the set deadlines;

    - a steering committee that ensures through regular meetings with the project manager that the project is on track and will be delivered within the set deadlines and also addresses any issues arising, such as conflicts with other priorities or reallocation of resources;

    - a project manager and project team that is responsible for the analysis of the project requirements,

    - the development of a work plan and budget; and

    - the actual implementation of the project plan to meet the deadlines.

42. In a project this size, the project manager and project team would normally be staffed with permanent resources along with contract personnel, where specific expertise is required. Given the current resources dedicated to this project it will be a challenge to implement IPSAS and achieve financial statements that are fully compliant with IPSAS by 2012. A more coordinated approach with Human Resources, Information Technology, and Procurement will likely be required to ensure the project's success.

43. Notwithstanding the ILO's current approach, progress has been made in developing IPSAS accounting policies and identifying the required process changes. The most significant ongoing challenge for the ILO will be to ensure that financial and non-financial data is identified and captured in a manner that meets IPSAS reporting requirements. This will require accelerated progress on financial, human resources, and general administrative systems in the field as well as at headquarters. Only with the required and complete data can the ILO succeed in its adoption of IPSAS as its accounting framework.

44. In the coming years, the ILO Financial Services Department will be challenged even further with the preparation of annual financial statements as well as the gradual implementation of IPSAS. These standards will require considerable work in terms of new disclosures in the financial statements, as compared with the UNSAS framework. The adoption of new IPSAS requires financial information that has neither been recorded nor disclosed in the past, and gathering this information for initial implementation will be challenging and resource-intensive.

45. Management is responsible for the ILO's transition to IPSAS. As the ILO's external auditor, we will monitor the transition process and proactively advise management and the Governing Body of our observations or concerns throughout the process.

Control environment at the ILO

46. In our first audit of the ILO, we focused on understanding the ILO's business, its regional financial operations, its accounting systems, its processes, the UNSAS accounting framework, the IPSAS standards that the ILO has implemented, and the new financial statement format. In our next audit, we will continue to work with ILO management on their phased implementation of IPSAS and focus on audit efficiencies.

47. Audit efficiencies are often possible when the audit adopts a controls-reliant-approach where the auditor can place reliance on the internal control system that management has put in place. To adopt a controls-reliant approach, a number of steps need to be completed. First, controls exercised by management need to be identified and documented to ensure the reasonableness of transactions. In addition, it is necessary to identify and test the existence of controls in the information technology systems

that affect the financial statements as well as manual controls that management has put in place to ensure that transactions are accounted for in accordance with the ILO accounting framework.

48. The Enterprise Resource Planning (ERP) system used by the ILO is the Oracle Business Suite and is commonly referred to as the Integrated Resource Information System (IRIS) at the ILO. The IRIS manages business processes, such as Human Resources, Finance, and Operational Management.

49. In April 2010, we carried out an evaluation of the IT general controls in the IRIS. We selected this system as it processes most of the financial transactions of the organization and is centrally managed and controlled. The first phase was to assess whether these general IT controls are adequate and working properly. If they were, we could obtain assurance that the internal controls were functioning and could be relied on. We are currently finalizing this work. Preliminary observations are that certain key controls are operating effectively and other automated controls could be improved. These observations are being discussed with ILO management, and a management letter will be issued in mid-2010 containing the observations and recommendations on improving the operation of these IT controls.

50. Prior to 31 December, 2010, we will follow up on the observations and recommendations on the IT controls in the IRIS. If management has addressed the weaknesses identified in the controls or if we are able to identify compensating controls that ensure that the internal controls are functioning as designed, we will proceed with the documentation and testing of selected application controls. Our intent is to review the applications that process headquarters payroll and regular budget expenses.

Conclusion

51. In summary, we are pleased with the progress made in the implementation of IPSAS in the 2008–09 financial statements. We encourage management to ensure this initiative continues as per the implementation plan presented to the Governing Body in November 2009. We would like to take this opportunity to thank the Director General, the Executive Director, Management and Administration Sector, the Treasury and Financial Comptroller and their staff for the excellent cooperation we received throughout the audit and we look forward to continuing our collaboration.