Board of the Centre

CC 77/7/2

FOR DISCUSSION AND GUIDANCE

SEVENTH ITEM ON THE AGENDA

Report of the Chief Internal Auditor for the year ended 31 December, 2013

Introduction

1. The Office of Internal Audit and Oversight (the IAO) of the International Labour Office provides internal audit services for the Centre. Chapter VIII, article 18(d) of the Financial Regulations stipulates that the Director of the Centre shall maintain an internal financial control and internal audit. IAO's mandate is established under article 14.10 of the Centre's Financial Rules, which specifies that "the Internal Auditor shall carry out such independent examinations and make such reports to the Director or persons designated by the Director….. in order to ensure an effective internal audit in accordance with Chapter VIII of the Financial Regulations."

2. The IAO's mission is to provide the Director of the Centre and the Board with an independent, objective assurance activity designed to add value and improve the Centre's operations. In its work, the IAO adopts a proactive approach to facilitating the assessment of risks and internal controls, and promotes a cohesive approach to risk management in support of management's processes to enhance efficiency, effectiveness and value for money in the activities of the Centre.

3. The IAO 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.

4. The IAO's audit activities conform to the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing.

Summary of audit results

5. In 2013, IAO issued three assurance audit reports:

    *   Two of the reports concluded audits initiated in 2012, which were conducted by external consultants contracted by IAO. The audits reviewed the Centre's cost accounting methodology used to allocate expenditure to training activities, and the cost-sharing arrangements with the two UN organizations hosted on the campus i.e. the United Nations Interregional Crime and Justice Research Institute (UNICRI) and the United Nations System Staff College (UNSSC). The reports made suggestions on how the respective methodologies could be improved to provide more complete and accurate management information on training activities; and an approach to ensure reimbursement of common expenditure from hosted organizations on a more consistent and equitable basis. The Chief Internal Auditor reported orally on the findings of these two reports to the 75th Session of the Board.

    *   The third audit report covered IAO's review of the Centre's Oracle e-Business Application and the Inbiz System, which is used to transfer payroll instructions to the Centre's banking partner (Intesa Sanpaolo) for payment. IAO identified opportunities to improve controls over the Centre's finance and procurement processes. As regards the Inbiz system, there was a gap in security that could have allowed a system override, which resulted in increased financial exposure to the Centre, albeit there would have been a low probability of it occurring. Once IAO pointed out this gap, the Centre took immediate corrective action.

Costing of the Centre's training programmes

6. The aim of the audit was to review the methodology of allocating expenditure to its training activities, including the allocation of fixed and variable costs, in order to determine the contribution towards fixed costs, and make recommendations for improvement as necessary.

7. The review found that the Centre's model of cost allocation allocated costs at the programme level; thus enabling an assessment of each programme's contributions towards fixed costs. While the Centre's current approach does provide senior management with information on financial performance at the programme level, the review identified opportunities to reassess the current methodology in order to determine the extent to which each training activity contributes towards fixed costs; thus providing senior management with more detailed information on financial performance within programmes, which could help inform decision-making and strategy.

8. The report suggested two different methodologies that could be used to provide more financial management information at the training activity level: one using the Centre's current technologies, and the other by enhancing IT systems to further automate the process, as well allow more accurate allocation of costs. Both suggested approaches would require revising and adapting the Centre's current methodology. However, the second suggestion of enhancing IT would require investment by the Centre. As costing of its activities is a fundamental component in determining contribution towards fixed costs, and this is a key performance measure, the Centre should consider reviewing its cost allocation methodology along the lines proposed by the consultants, but any decision to invest in enhancing its IT capacity would need to be taken in light of current priorities and availability of resources.

9. The audit also made a number of more detailed recommendations to:

   - enhance roles and responsibilities on allocation and cost control activities (the Centre may have to consider availability and profile of resources to fully implement this recommendation); and
   - further develop and formalize policies and procedures with respect to the cost allocation process and pricing of training programmes.

Cost-sharing arrangements on the campus

10. While conducting the audit of the Centre's costing arrangements of its training activities, the consultants also reviewed the methodology used to allocate relevant common expenditure to the hosted UN organizations, UNICRI and UNSSC, to assess the amount that they should reimburse the Centre. The review found that methodologies applied for each organization were not consistent, have not been fully formalized, and do not capture all relevant costs for reimbursement. This therefore provides the Centre with an opportunity to revisit its cost sharing methodology and seek a more consistent and complete approach. The report provides guidance on how this may be achieved.

11. Once the Centre has decided on an approach to adopt, it should formalize it in a policy document. Not only would this help ensure consistent and equitable application of the methodology, it would also facilitate any future revisions that may be needed due to changes in the campus environment or with hosted organizations.

Oracle e-Business application

12. The Centre relies on Oracle applications to support its processes and provide key internal control over financial matters. Given the importance of Oracle to the Centre, IAO reviewed controls over security, segregation of duties, user administration, procurement and supplier payment processing, and software licensing agreement.

13. IAO identified opportunities to improve the control environment of the finance and procurement processes by implementing additional features of the Oracle application software to replace less efficient, paper-based processes, which are currently in place. The processes to implement include workflows for approving purchase orders and supplier invoices, tolerance limits for accepting minor differences between purchase order and supplier invoice amounts, and processing receipts for goods and services. Any cost implications of reworking the business workflows would need to be balanced against other priorities and available resources.

14. The audit also determined that the responsibilities assigned to eight users in the FINSERV section have not been adequately segregated within the Oracle e-Business application. Although there are manual, paper-based controls for approving purchase orders and supplier payments, the conflicting access privileges identified increase the risk of unauthorized payments. Following a review of user accounts, IAO identified gaps in the number of Oracle licenses which have since been resolved with the support of the ILO.

15. Following the request by the Treasurer to review controls over the *Inbiz* system, which is used to transfer payroll instructions to the bank for payment, IAO found that the holder of the *Inbiz* system master user function could override the control that requires two authorized signatories to approve the monthly payroll file. This meant that the user could prepare international payment orders for unlimited amounts without requiring further approval. As a result of this possibility of user override, there had been a risk that unauthorized payments up to the value of the contents of the Centre's bank accounts might not have been prevented. The Treasurer initiated immediate corrective action subsequent to being informed of this control deficiency.

Audits underway during 2014

16. At the time of writing this report, IAO has completed the field work for the audit of internal governance and the report shall be issued shortly. The Chief Internal Auditor shall provide an oral update on this audit of governance at the Board meeting in October 2014.

17. IAO plans to undertake a review of the Centre's training activities in August 2014, and has planned a review of procurement later in the year. The results of these audits will be reported to the Board at its 2015 session.

This report is submitted to the Board for discussion and guidance.

Turin, 17 June, 2014