



# United Nations Industrial Development Organization

Distr.: General  
5 April 2019

Original: English

## Industrial Development Board

### Forty-seventh session

Vienna, 1–3 July 2019

Item 12 of the provisional agenda

### UNIDO Independent Audit Advisory Committee

## Report of the Audit Advisory Committee

### Report by the Chair

This document is issued pursuant to decision IDB.44/Dec.4 on the establishment of an Independent Audit Advisory Committee (AAC) and in line with the terms of reference adopted with the same decision. The present report provides information on the AAC's activities and advice.

## I. Progress to date on priority areas

1. Since the inception of its activities in January 2018, the AAC has met twice at UNIDO's Headquarters and held multiple virtual meetings. The AAC focused on three priority areas defined in its work programme for 2018–2019<sup>1</sup>. The progress made so far by UNIDO, with the AAC's support, is summarized below.

2. **Priority One:** Accelerate the implementation of audit recommendations by External Auditor, internal auditor, and Joint Inspection Unit (JIU).

3. Achievements:

(a) Decrease in outstanding internal audit recommendations: As a result of the internal audit intensive follow-up on outstanding recommendations, the number of outstanding recommendations and management action plans (MAPs) from past internal audit engagements decreased from 149 in 2017 to 88 in March 2019;

(b) Increased management ownership of Action Plans: The Internal Oversight Division, within the Office of Evaluation and Internal Oversight (EIO/IOD), modified its audit approach from providing recommendations to management, to actively discussing control deficiencies and helping management develop MAPs. The new approach has increased management's ownership and accelerated the implementation of agreed MAPs;

<sup>1</sup> Document IDB.46/16.

For reasons of economy, this document has not been printed. Delegates are kindly requested to bring their copies of documents to meetings.



(c) Prioritization of audit observations: EIO/IOD adopted a new approach to prioritizing observations in individual engagements based on risk. This approach helps MAPs be focused on areas of high importance, risk and impact, and reduces the overall number of actions management needs to implement.

4. What is outstanding:

(a) Escalation of management's risk acceptance: EIO/IOD needs to develop a process for escalating audit issues to the AAC and the Board when management decides not to take actions to address audit issues based on its own risk tolerance;

(b) Consolidation of outstanding internal audit recommendations: To further accelerate implementation of important outstanding internal audit recommendations, it is necessary to analyse the remaining recommendations by theme and risks and prioritize implementation in alignment with UNIDO's strategy; EIO/IOD began this process in March 2019;

(c) Coordinated tracking of recommendations and actions from various reviews: To benefit the most from various reviews conducted by different assurance providers, repeated or similar issues across these reviews need to be identified. This will allow management to prioritize issues and MAPs and respond to individual findings in a coordinated manner. At present, issues identified in these reviews are evaluated, responded, and tracked without coordination.

5. **Priority Two:** Increase the alignment of the internal audit work programme with UNIDO's business objectives, strategies and risks.

6. Achievements:

(a) New approach to develop a work programme: EIO/IOD revised its risk assessment methodology, which drives the work programme development, to improve its alignment with UNIDO's strategic priorities and objectives. IOD's 2019 workplan focuses on business activities that are critical for the achievement of UNIDO's strategic objectives and high risks;

(b) Improved coordination with other assurance providers: EIO/IOD analysed, in consultation with the Risk Management Committee (RMC), how key risks of UNIDO were monitored and assured by various functions. This helped EIO/IOD identify risks not covered by other functions and focused its efforts on those risks.

7. What is outstanding:

(a) Coverage of high-risk business activities: Due to the limited resources allocated to internal audit, important high-risk business activities are not covered in the work programme, namely, institutional governance process, enterprise risk management, and information technology;

(b) Risk input from risk monitoring function: EIO/IOD does not systematically receive risk information from institutional risk monitoring functions due to the nascent stage of enterprise risk management. Regular exchange of risk information between internal audit and risk monitoring functions will enhance the risk focus of EIO/IOD's workplan;

(c) Financial audits: EIO/IOD spends significant resources conducting annual financial statement audits of the Catering Services and Major Repair and Replacement Fund, which is not aligned with UNIDO's strategic priorities or risks. The external quality review recently conducted also pointed out that EIO/IOD is not appropriately resourced to undertake financial statement audits. The Secretariat will explore the possibility of transferring these financial audits to the External Auditor, which the AAC strongly supports.

8. **Priority Three:** Strengthening of the internal audit function in reference to leading professional practices.

## 9. Achievements:

(a) External quality assessment: An independent external assessment of EIO/IOD in March 2019 performed by the Institute of Internal Auditors (IIA) concluded that UNIDO's internal audit practices are **generally conformant** with the professional standards. This is the highest possible rating. The assessment particularly acknowledged the significant improvement of quality made in 2018 and 2019;

(b) Revision of the quality assurance and improvement programme (QAIP): EIO/IOD updated its QAIP in 2018 to further strengthen monitoring and supervision of the internal audit activities, as well as embed continuous improvement in the process;

(c) A new Charter for the Office of Evaluation and Internal Oversight: The previous Charter was updated as part of the new EIO Charter, consistent with the IIA's professional standards, and synchronized with the UNIDO Evaluation Policy.

## 10. What is outstanding:

(a) EIO's independence: The AAC considers that EIO is not sufficiently independent from management for the following reasons: (i) EIO's Charter is not approved by the Board; and (ii) the appointment, and termination, of the Chief Audit Executive (Director, EIO) does not require the involvement of the AAC nor the Board. Actions to address these points involve changes to the existing governance framework of the Organization. The AAC intends to work with management to increase EIO's independence and submit its corresponding recommendations to the Board;

(b) An integrated EIO strategy: To realize the benefits of the organizational integration of the internal audit, investigation, and evaluation functions under the EIO directorship in 2018, an integrated EIO strategy that lays out approaches for achieving synergies and complementarity across these functions is necessary. EIO initiated the development of such strategy;

(c) Resources allocated in the proposed programme and budgets, 2020–2021: The proposed budget does not foresee an increase in the number of auditor positions. The outsourcing of the financial statement audits (para. 7 (c)) will enable EIO/IOD to use its limited resources more efficiently. In the long term, however, a more sustainable resource solution for a limited operational budget is needed to expand the coverage of high-risk activities.

## II. Other areas for consideration

11. **Enterprise Risk Management (ERM):** The AAC considers that the establishment of an effective ERM function is crucial for UNIDO to systematically assess and manage its risk. While the RMC remains nascent and is not sufficiently staffed, it has taken important first steps to introduce ERM to UNIDO. It has developed an ERM methodology suitable for UNIDO, and has endorsed an ambitious workplan for 2019 that focusses on: completing a full risk assessment; identifying risk appetite and risk tolerance; creating a risk register that shows mitigation plans and risk owners; socializing and integrating ERM across the Organization, and operationalizing a Risk Liaison Officer function. These are all important steps as risk management matures at UNIDO.

12. **Terms of reference (ToRs) of the AAC:** In alignment with the recent integration of internal audit, investigation, and evaluation functions, the AAC considers that the expansion of its scope to cover all three functions is important. At present, AAC's scope of work does not include advice on investigation and evaluation activities. The AAC intends to initiate a discussion with the Board and management to amend its ToRs.

13. **External Audit:** This report does not cover the 2019 Report of the External Auditor as the AAC has not yet received it. The AAC will share its comments on the

report, once received, with the Board through the Programme and Budget Committee, in the form of a conference room paper.

### **III. AAC budget and resource usage**

14. The AAC spent the full €88,000, budgeted for 2018–2019. The AAC is pleased that the budget proposal for 2020–2021 includes an increase of 38 per cent. If adopted, this will allow the AAC to have two annual physical meetings at UNIDO Headquarters per year as suggested in the last report. The AAC would appreciate such decision by Member States.

### **IV. Action required of the Board**

15. The Board may wish to take note of the information provided in the present report and provide guidance on, (a) actions to increase the independence of EIO, (b) expansion of the AAC's scope of work to include investigation and evaluation, and (c) approval of the proposed increase of the AAC budget for 2020–2021.

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