

Report of the External Auditor

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National Audit Office

REPORT TO THOSE
CHARGED WITH GOVERNANCE
April 2011

Pan American Health Organization

Long Form Report on the 2010 financial statement audit

The aim of the audit is to provide independent assurance to Member States; to add value to the organization's financial management and governance; and to support the objectives of the organization's work through the external audit process.

The National Audit Office (NAO), headed by the Comptroller and Auditor General of the United Kingdom, Amyas Morse, provides an external audit service to the Pan American Health Organization. The External Auditor has been appointed by the Member States in accordance with the Financial Regulations. In addition to certifying the consolidated financial statements of the Pan American Health Organization, he has authority under the mandate to report to the Member States on the economy, efficiency and effectiveness with which the organization has used its resources

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Executive Summary

Introduction

- 1 We have provided an **unqualified audit opinion** on the 2010 consolidated financial statements which present fairly, in all material respects, the financial position and the results of operations and cash flows; and we confirm that our audit revealed no weaknesses or errors which we considered to be material to the accuracy, completeness and validity of the consolidated financial statements.
- 2 The 2010 consolidated financial statements of the Pan American Health Organization (PAHO) are the first to be prepared using the International Public Sector Accounting Standards (IPSAS) and an unqualified opinion represents the successful culmination of a significant level of effort and commitment from all the staff at the Organization.
- 3 The efforts of PAHO in successfully moving to an internationally recognized accounting framework will provide the Member States and management with better financial information to use in managing the business of the Organization. The benefits that IPSAS can now bring should be utilised to ensure that the efforts made contribute towards more efficient and effective use of resources as a result of the improved management information.
- 4 PAHO now needs to capitalise on the achievement of implementing IPSAS to use the momentum they have gained to effect additional changes to the current work practices to fully embed IPSAS within the Organization.

Overall Results of the audit

- 5 We have audited the consolidated financial statements of PAHO in accordance with the Financial Regulations and International Standards on Auditing.
- 6 The audit opinion confirms that these financial statements: present fairly, in all material respects, the financial position as at 31 December 2010 and the results for the year then ended; have been properly prepared in accordance with IPSAS and the stated accounting policies; and, in all material respects, the transactions underlying the financial statements have been made in accordance with the Financial Regulations and applied to the purposes intended by the Pan American Sanitary Conference or the Directing Council.
- 7 Our audit procedures are designed primarily for the purpose of forming an audit opinion. They included a review of the internal controls and accounting systems and procedures, only to the extent considered necessary for the effective performance of the audit. The audit work did not involve a detailed review of all aspects of PAHO's budgetary and financial information systems. Our findings therefore

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should not be regarded as representing a comprehensive statement of all the weaknesses which exist, or all improvements which could be made to the systems and procedures operated

8 The main observations and recommendations from our audit are set out below. Our recommendations are summarized in Annex A. Action taken by management in response to our 2008-2009 recommendations is set out at Annex B.

Financial Overview

Overall Summary of Results

9 These are the first audited consolidated financial statements prepared using International Public Sector Accounting Standards (IPSAS) and as such, they provide Member States with transparent good quality and reliable financial information as to the activity and state of affairs of PAHO at the 31 December 2010. This is the first year under a new annual reporting cycle. Previously PAHO published audited financial statements each biennium.

10 The Director's Report on the Financial Statements provides a comprehensive analysis of the financial performance of the Organization for 2010. The analysis includes comments on revenue and expenses as well as the assets and liabilities of the Organization. We review the financial analysis provided for consistency with the consolidated financial statements.

11 From our audit of the consolidated financial statements we have identified a number of issues that we feel it is appropriate to highlight in this report as follows:

- The results showed a small surplus of revenue over expenditure, an excess of assets over liabilities and a small cash outflow for the period.
- As at 31 December 2010, there are sufficient funds available to meet reported current liabilities as they fall due. There are wider issues around the ability to meet long term employee benefit liabilities which have been discussed further in paragraphs 20 to 25.
- PAHO continues its rapid growth in overall activity, a trend also seen in the recent biennia. One of the key drivers of this growth continues to be the increasing amounts of money which are given to PAHO to purchase vaccinations and equipment on behalf of Member States. Revenue recognized for the procurement of public health supplies amounted to \$541 million and makes up approximately 58 percent of total revenue.
- The growth of PAHO activity in Brazil has continued. Voluntary contributions received from Brazil for projects to be implemented in Brazil amounted to US\$106 million for the year (compared to US\$165 million in the previous biennium).

Key areas of focus

12 There are 3 areas we have set out in more detail below because we believe them to be areas of interest to PAHO and its Member States:

- ***Voluntary contributions*** – where there are significant changes in the accounting under IPSAS;

- **Employee benefits liabilities**– where there are significant changes in the accounting under IPSAS; and
- **Government financing for internal activities** – where the activities have continued to expand.

Voluntary Contributions

13 PAHO receives a significant proportion of funding in the form of voluntary contributions earmarked for specific projects, referred to as trust funds. The Financial Regulations allow for PAHO to engage in these types of projects providing any conditions which may be attached to them are consistent with the objectives and policies of the Organization. A trust fund agreement is set up to outline what the monies are to be spent on and what activities are required throughout the lifecycle of the project.

14 There has been a significant change in the way that voluntary contributions have been accounted for as a result of the introduction of IPSAS and this has impacted on the way these are presented in the financial statements.

15 In previous biennia, the recognition point for this type of revenue was when cash had been received by PAHO from a specific donor. This is no longer the case. PAHO has a claim to these funds where there is a written agreement signed by both PAHO and the donor; this is now the point at which PAHO recognises the revenue or deferred revenue.

16 Some written agreements for voluntary contributions cover periods of several years. Where there are conditions attached to the revenue (PAHO must spend the money according to specific criteria, and returns the money if this is not done) the revenue is recognised in the consolidated financial statements only when the conditions have been met.

17 PAHO's projects are typically between one and three years long, although some have expiry dates as far as 2016. As a result, the revenue pertaining to future year's activities is deferred and is reflected as an asset in PAHO's statement of financial position, rather than being recognised as revenue in the current year. There was no corresponding asset in the 2008-2009 published financial statements. This has given rise to an overall receivable of \$138 million, of which \$80 million is projected to be received in 2011 and \$58 million relates to future years. This is disclosed in Note 6 of the consolidated financial statements. The receivable does not equal the deferred revenue balance, because some donors provide funding in advance. This gives a more accurate picture of the future funding arrangements that PAHO has secured and ensures that the revenue is recognised when conditions are met, as the project is delivered.

18 In the event, that PAHO is unable to use the money as set out in the agreement within the project timeframes, it is refunded to the donor and \$1.4 million of unused funds were returned in 2010. Pledges and funds received are recognised as a liability, known as deferred revenue, in the financial statements until PAHO has met the conditions required to recognise the revenue. PAHO is reporting deferred revenue of \$314 million disclosed in Note 12 of the consolidated financial statements. There was no corresponding liability in the previous biennium.

19 As explained above, voluntary contributions received are only recognised as revenue as the underlying project is implemented in accordance with the conditions set out in the agreement. The amount of revenue from voluntary contributions for trust funds recognised in the Statement of Financial Performance was \$200 million, which makes up approximately 21 percent of total revenue in 2010.

Employee Benefit Liabilities

20 The liability for post employment benefits of staff and other separation benefits are recognised by PAHO in the consolidated financial statements. The total value of these liabilities was estimated as at 31 December 2010 as \$268 million, which represented an increase in the year of \$56 million compared to the liability of \$212 million at 31 December 2009. The main elements of the liability have been estimated by the consulting actuaries employed by PAHO (Aon Hewitt Associates) and are based on a series of assumptions. These are disclosed in note 11 to the consolidated financial statements. The main cause of the growth in the reported liability is an increase in the estimate of annual medical costs for each current and former staff member, and a further reduction in the discount rate used to calculate the liability, reflecting the continued low interest rate environment.

21 A smaller amount of \$220 million has actually been included in the consolidated financial statements as a liability of PAHO. This is less than the total potential liability calculated by the actuaries because PAHO has opted to defer the recognition of US \$48 million share of the liability that arises from actuarial losses¹. The actuarial loss will be recognized on a systematic basis over a period of time as permitted by IPSAS 25.

22 2010 is the first time that these liabilities have been reported in the financial statements, and this has a significant impact on the overall presentation of PAHO's financial position compared to the 2008-09 biennium. PAHO has a mechanism for funding the current liability internally and have set aside money in an irrevocable trust to meet future liabilities. As at 31 December 2010 the amount of funds available was \$35 million leaving a significant long term liability relating to employee benefits that will eventually have to be funded by its Member States.

23 It is important to understand that this actuarial valuation is an estimate of the long term liabilities and does not represent a payment that needs to be made in the immediate future. It has been calculated after taking into consideration assumptions regarding future medical expenses and other separation benefits that may be incurred by existing and former staff members who have already qualified for these benefits. Changes in these assumptions and the rate of inflation could significantly change the estimate of the liability. The actual cash payments to meet these medical expenses and other separation benefits will occur over several decades.

24 PAHO has detailed information to model and monitor the future cash flows and should agree with its Member States a long term plan to meet these liabilities.

¹ IPSAS 25 states that actuarial gains and losses comprise "experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and the effects of changes in actuarial assumptions". Paragraphs 105 to 107 of this standard provide guidance on how actuarial gains and losses may be recognised.

25 Recommendation 1: PAHO should consider how it can best use the information on employee liabilities that is required under IPSAS, to ensure it plans to have funds available to meet these liabilities as they become due.

Government Financing for Internal Projects

26 There has been a continued increase of governments providing financing for internal projects. Out of the total \$129 million government financing for internal projects for the year ended 31 December 2010, amounts received from Brazil amounted to \$106 million.

27 We reviewed two activities during our work in Brazil we considered to be atypical of PAHO's usual programme activity. We set out more details of the two activities below, as, in our view the continued expansion of PAHO's implementation of large scale procurement for internally financed government contributions can increase the level of risk PAHO is exposed to, and is required to manage.

Procurement of computer equipment

28 PAHO entered into a contract with a total value of \$8.8 million to be executed in 2010 for the purchase and delivery of IT equipment to universities in a number of different states in Brazil for the "Telehealth" Project. PAHO told us that this was part of their technical cooperation role. The strategic objective of this project is to encourage participant universities to adopt common standards for Telehealth and Open University projects. These projects are designed to improve local and regional access to health through an improved telecommunication network. PAHO told us that their role was to assist the universities to implement universal standards promoted by PAHO, and help with the necessary equipment and connectivity for the Telehealth project, by reinforcing regional interoperability.

29 A total of \$8.2 million was spent in 2010, representing 93 per cent contract completion. PAHO has disputed with the supplier the remaining 7 per cent of the contract; PAHO informed us that the supplier has stated that all the equipment has been delivered, but PAHO does not have a record of receipt of the equipment and has not paid the remaining 7 percent of the contract value.

Procurement of management consultancy services

30 In 2008 PAHO entered into a contract with a total value of \$6 million to provide consultancy services relating to the re-organization of the Brazilian Ministry of Health. To date there have been three phases of this project, and each phase has been an extension of the original contract. PAHO has told us that phase three, which was entered into in April 2010, is the final extension. However, we understand that phases 1 and 2 were approved on the basis that there would be no extensions. The deliverables of the project included diagnostics, analyses of the structural organizational processes presently in use by the Ministry of Health and proposals for a new structure based on the studies realised. PAHO told us that based on this suite of products the Ministry of Health in Brazil can thoroughly evaluate their options and make an informed decision.

31 PAHO told us that their involvement was part of their technical cooperation role because PAHO has a mandate to strengthen the governance of National Health Authorities throughout the region. PAHO told us that their prior experience and expertise in developing strategies to modernize government institutions was one of the key factors behind the Brazilian Ministry of Health seeking PAHO's involvement.

32 The contract for these consultancy services was not competitively tendered. PAHO told us that they carried out research to identify suppliers with the qualifications and experience with public institutions, and identified that there were very few suitable suppliers. PAHO's research identified that most of the potential suppliers who had experience with the public sector performed their work using very rigid methodologies, which was not suitable for their work.

33 Both of the contracts above were considered by PAHO's Contract Review Committee and approved by the then Director of Administration. The Financial Regulations allow PAHO to accept voluntary contributions provided that "any conditions which may be attached to them are consistent with the objectives and policies of the Organization". The objectives of the Organization are set by the Directing Council as part of the Strategic Plan. These include Strategic Objective XII – "to ensure improved access, quality and use of medical products and technologies" and Strategic Objective X – "to improve the organization, management and delivery of health services." We recognise that the projects outlined above contribute to those objectives.

34 However, in our view increasing the levels and types of procurement for internally financed voluntary contributions that PAHO engages in could increase the risk the Organization is exposed to; detract from its own core purposes at an American regional level; and impact on the capacity of PAHO's staff to manage its activities.

35 Recommendation 2: we recommend that PAHO carry out a formal risk assessment for high value procurement contracts or contracts that are in new areas of activity. PAHO's mitigation of risks associated with single source procurement should be fully documented.

Implementation of International Public Sector Accounting Standards

Introduction

36 The financial statements for the year ended 31 December 2010 are the first to be prepared using International Public Sector Accounting Standards (IPSAS). We propose an unqualified audit opinion on these consolidated financial statements which represents a major achievement for the Pan American Health Organization as one of the first international organizations to adopt IPSAS. The successful transition represents a significant achievement and is the result of considerable management time and effort.

37 The IPSAS framework is more prescriptive than the previous reporting framework under United Nations Systems Accounting Standards (UNSAS) and this has led to significant changes in the presentation, format, terminology and accounting treatments of certain transactions. The implementation of IPSAS has strengthened the overall quality of financial reporting, providing more comprehensive information and greater transparency over the use of resources. Improved financial information will help the Organization better assess its financial health and help longer-term financial planning and decision making.

Format of the Financial Statements

38 Under IPSAS, the consolidated financial statements now provide a complete statement of assets and liabilities, which are under the control of the Organization, on an accrual basis and reflect the full consumption of resources in 2010. This has led to a number of changes in the way the financial statements are presented. The following sections of the report detail the key changes, and some of their consequences.

39 There are now five primary statements supported by notes to provide further explanations on the policies adopted and to explain the composition of key balances. These are the:

- Consolidated Statement of Financial Position as at 31 December 2010, which shows all the assets and liabilities of the Organization;
- Consolidated Statement of Financial Performance for the year ended 31 December 2010. This statement shows all the revenue and expenditure recognised during the year;
- Consolidated Statement of Changes in Net Assets for the year ended 31 December 2010, summarising the residual interest in the assets of the Organization, after deducting all liabilities;

- Consolidated Statement of Cash Flow to provide details of how cash resources have been utilised during the year; and
- Statement of Comparison of Budget and Actual Amounts, showing expenditure against budget appropriations on the basis on which the budget was approved.

40 We issue an audit opinion on the consolidated financial statements which covers the primary statements and the supporting notes, but excludes the unaudited informational annex. Our audit opinion does not cover any other information. We do, however, read the other information, which comprises the Director's Comments, and consider whether it is inconsistent with the financial statements.

Consolidated Statements

41 IPSAS 6, 'Consolidated and Separate Financial Statements' requires the consolidation of funds over which an organization has control. PAHO has an important role in managing the following Sub-Regional Centers:

- The Caribbean Epidemiology Center (CAREC); and
- The Caribbean Food and Nutrition Institute (CFNI).

42 A review was carried out by PAHO to determine whether PAHO did in fact exercise control of these organizations despite these organizations having their own governing bodies. PAHO concluded, and we agreed, that there was sufficient evidence of PAHO's control of these entities, as PAHO appoints key management personnel and reviews annual work plans, and that therefore they should be fully consolidated into PAHO's financial statements.

43 PAHO also has a role in managing in the Latin American and Caribbean Center on Health Sciences Information (BIREME) and other Centers such as PANAFTOSA, CEPIS and CLAP. These do not have their own governing body structures and are not considered separate entities. They are fully reported within PAHO's core activities segment.

44 The consolidated financial statements therefore report the assets, liabilities and financial performance for the group as a whole. These Centers have not prepared or submitted separate financial statements for audit and we have not provided an opinion on these individual entities. Financial information regarding CAREC and CFNI has been included in the Unaudited Informational Annex.

Restatement of the opening balances (Statement of financial position)

45 Under UNSAS, PAHO prepared a balance sheet, but UNSAS did not require the full reporting of assets and liabilities that would enable a reader to understand the value of the net assets and liabilities of an organisation. Such a statement is required under IPSAS – the Statement of Financial Position – and

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this enables a reader to consider the financial position of an organisation, whether it has net assets or net liabilities, and changes in the position over time.

46 The production of “opening balances” for the Statement of Financial Position was a major challenge for PAHO. Some assets and liabilities previously reported in the UNSAS balance sheet had to be revalued to comply with IPSAS, and some assets and liabilities had to be included for the first time. This exercise required a significant investment of time and effort by PAHO staff.

47 IPSAS required some significant changes to accounting treatments resulting in large movements in the opening balances at 1 January 2010 to bring the previous balances in line with the requirements of the new framework. The adjustments are disclosed in note 24 of the financial statements demonstrating the movements between the UNSAS closing balance and the IPSAS opening balance.

48 The key movements comprise:

- The classification of assets and liabilities between current and non-current dependant on whether they expect to be realised within the next 12 months or in more than 12 months;
- The consolidation of the Sub-Regional Centers referred to above;
- The recognition of property, plant and equipment as non-current assets in the Statement of Financial Position which was previously reported as non-expendable equipment in a disclosure note to the account;
- The valuation of property in Washington DC headquarters and the Country Offices at current market value increasing the previously reported value by \$92 million, reflecting an increase in the value of these properties since their construction or acquisition;
- The recognition of the employee benefits liability for After-Service Health Insurance and Termination and Repatriation Entitlements of \$212 million split between the current and non-current elements;
- The recognition of amounts paid into the revolving procurement funds by Member States in advance of need as a deferred revenue liability rather than a reserve; and
- The adjustment to the Voluntary Contributions Receivable to recognise an asset from voluntary contributions at the point at which a signed, binding agreement is entered into rather than when the cash is received. A deferred revenue liability was created to reflect amounts received and committed, which have conditions attached that were not yet discharged.

49 Overall, the restatement of opening balances has reduced the balance on the reserves account by \$404 million to the reserves balance as at 31 December 2010 of \$102 million. This decrease is primarily the result of the first time recognition of long term liabilities which PAHO will be required to meet. The positive balance of reserves demonstrates that PAHO continues to have sufficient resources to meet its obligations.

Changes in Accounting Treatment (Statement of Financial Position and Statement of Financial Performance)

50 Paragraphs 40 to 49 above set out the requirements for producing a **statement of financial position**, and the degree of challenge involved. However, the **statement of financial performance** also required significant work, as PAHO needed to recognise all its revenues and expenditure on an accruals basis. The accruals basis means that recognition of the revenue or expenditure is required when the underlying activity takes place, rather than when the cash flows occur. This means that revenue and expenditure under IPSAS represents the true cost of an organisation's activities, enabling a reader of the accounts to review performance (and the net position of revenues and expenditures – surplus or deficit) over time.

51 The paragraphs below set out the key changes to the accounting policies as a result of IPSAS implementation and the accruals basis of accounting that affect both PAHO's statement of financial position and statement of financial performance. The significant changes to accounting treatment are:

- Expenditure is now recognised on the delivery principle, showing how the assets and resources of the Organization are being consumed, and not just how much cash has been paid. Note 15 outlines in more detail how PAHO has been spending the funds provided, setting out amounts applied to staff costs, supplies, commodities and materials, and other items;
- Revenue and expenditure in relation to the revolving procurement funds, which are used to purchase vaccines for participating countries, are fully reported in the Statement of Financial Performance as exchange transactions, once delivery of the vaccines is confirmed. This is because PAHO takes responsibility for these vaccines and assumes the risks and rewards of ownership during the procurement process;
- A new revenue recognition policy in respect of voluntary contributions received for projects managed by way of a trust fund agreement, so that revenue is now only realised as the project is implemented. The accounting treatment for these agreements has already been discussed in detail in paragraphs 13 to 19;
- The inclusion of land and buildings owned at a current market value gives the users of the consolidated financial statements the most up to date information on the value of these assets, as the original purchase price is no longer a fair reflection of their true worth. PAHO has decided to use independent valuers to determine current market value, and is aiming to carry out this exercise every three to five years. Where an asset has been donated to the Organization but the restrictions on this are such that PAHO does not have free use of it, a corresponding liability has been established;
- The full recognition of the employee benefits liability for After-Service Health Insurance and Other Employee Benefits in the consolidated financial statements of \$220 million split between the current and non-current elements;
- Under IPSAS, the reserves and fund balances of \$123 million reported in the Statement of Financial Position only include the share of the overall net assets of the Organization that are within the control

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of its Member States. Reserves are established where the use of funds has been restricted by either a specific resolution by the governing bodies or the Financial Regulations. Fund balances are the unexpended balance of contributions that are set aside for future purposes, and include money that PAHO has set aside to finance the revolving procurement activity of \$88 million;

- The consolidated financial statements now include much more disclosure of PAHO's cash and investments, which is a significant balance. The Statement of Financial Position now reports \$485 million of cash; cash equivalents; short and long term investments. (There is an additional ring fenced amount of cash and investments of \$35 million held in an irrevocable trust to meet future employee liabilities). While this makes the Organization look in a healthy financial position, not all of this is at the free disposal of PAHO. Approximately \$180 million of these funds are earmarked for specific projects, with another \$150 million representing advances paid by Member States into the revolving procurement funds; and
- The Comparison of Budget and Actual Amounts no longer aligns directly with expenditure reported in the Statement of Financial Performance, with the budget prepared on a cash basis and not including the full activities of PAHO. Until the budgeting process is developed to align with the more objective and comprehensive accounting standards, PAHO will need to identify and explain the differences to its Member States.

Comparative Information

52 International Public Sector Accounting Standards (IPSAS) are an objective and comprehensive set of reporting standards. These Standards recognise the difficulties that many organizations will face in developing systems to produce the additional financial information now required. However, in order to encourage organizations to make the change, they have included specific provisions to make the transition smoother. They do not ask for historical financial data to be presented on a comparable basis; allowing the option of not presenting any comparative figures for the previous period in the first year of adoption of the new standards.

53 This is a once only transitional provision which PAHO has chosen to apply. Going forward, the financial information will be presented annually and contain direct comparative figures for all of the financial information. This will help Member States to quickly identify any changing trends in the activities performed and ask the relevant questions of the Organization.

External Auditor Comments on First Year Implementation

54 The IPSAS project was an extremely challenging undertaking for all the staff involved at PAHO, and for the auditors. The initial timetable endorsed by the 27th Pan American Health Conference in October 2007 for full implementation by 2010 has been met. This is a positive reflection of the hard work and commitment of PAHO staff.

55 Overall, we have been very impressed with the level of enthusiasm and energy with which PAHO has tackled the implementation project. We consider that the Organization and its staff should rightly be proud of its achievement. We have outlined some of the key points we think PAHO has done particularly well:

- Clear project planning, with working groups established to address individual key themes and consider the necessary process changes that would be required; this meant that the finance staff took full ownership of the project throughout;
- The project was not just restricted to key finance staff. Instead, IPSAS and its fundamental principles were communicated to all staff across the Organization. This meant it was not simply seen as an isolated finance project, but viewed as part of a much bigger move towards openness, transparency and improved financial reporting;
- Open engagement with the External Auditors, consulting on matters of accounting principle throughout the project lifecycle, which helped avoid disagreements during the year end final audit process; and
- The preparation and delivery of proforma consolidated financial statements through the year, giving the External Auditors the opportunity to provide early critical challenge and positive input into their format.

56 We also identified some areas where we think the Organization can learn lessons from the experience and represent scope for future improvements. These should be addressed in subsequent financial periods:

- There is scope for better management and supervision of the role of Country Offices in the implementation process. Failure to comply with central instructions at country level, can have significant consequences on the timeframes of year end closure and can threaten PAHO's ability to meet its reporting deadlines;
- Country Offices need to comply with instructions and provide robust accounts information. Our audit visit to the Brazil Country Office in January 2011 identified material errors in the reported expenditure for the year as this office had not properly implemented year end cut-off;
- The amount of financial resources and staffing requirements of the project were not fully understood at the outset. In our view, this led to finance staff being overstretched through the implementation period, and the project became dependent on key individuals. The final delivery was put at risk from the possibility of staff leaving or suffering from illness; and put significant additional pressure on the external audit team; and
- There is the need to challenge and fully understand the information that is provided by experts prior to its inclusion, to ensure it is free from error and accurately represents the state of affairs of PAHO. Management will have a much greater understanding of PAHO's operations and are well placed to review and check the validity of the data; however the project plan should provide sufficient time to allow this process to be carried out.

57 Recommendation 3: We recommend that PAHO staff carry out a full diagnosis of its experiences of implementing IPSAS and identify those areas where there is further scope for improvement. A clear action plan should be developed to address these weaknesses.

Developing the Benefits of IPSAS

Introduction

58 The transition from cash accounting to full accruals based accounting under an internationally recognized comprehensive framework is a complex and resource consuming exercise. It is not just a change in the presentation of the consolidated financial statements, or simply a project implemented and managed by finance staff, but a much wider shift to a way of working that will permeate all areas of PAHO's operations. It will influence the cultural behaviours of staff, it will develop financial and management information systems, and it will bring about greater clarity over processes and operating procedures.

Cultural Changes

59 The cultural shift will manifest itself in the way staff plan and record activities throughout the Organization, with project and other information being updated on a regular basis, and accurately recorded. This includes the use of experts to provide guidance on the valuation of complex assets and liabilities, making sure these are accurately reported to Member States. Better financial discipline and better training in the basic principles of accounting concepts should produce more qualified staff, with greater financial competencies developing in technical units and Country Offices.

Management Information

60 Underlying financial and information systems need to be more robust, to accurately present the actual progress in implementing projects and understand the resource consumption at any point in the year. Improved financial and inventory systems, populated with good quality data, improves management reporting and provides senior management with reliable and up to date information with which to plan the use of resources and oversee activities across the Organization. The benefits are not just restricted to senior management. Area managers and Country Office Representatives will also welcome the introduction of more timely and accurate information, allowing them to make informed business decisions and manage the risks of the projects and operations over which they have responsibility.

Policies and Procedures

61 Operating policies and processes could be strengthened to ensure that major transactions and arrangements are accounted for correctly. Our work has highlighted areas where this can be improved. For example, when we reviewed the treatment of the revolving procurement funds, there was no clear definitive policy on when PAHO should pay suppliers for the purchase and delivery of vaccines and other supplies.

Specific areas for development

62 PAHO will need to look at some of the specific problems which arose during the implementation process if it is to maximise the benefits from the implementation of IPSAS. These problems often highlighted areas where underlying systems, management and project information could be significantly improved. In particular, they often resulted from gaps in management information, and areas where operating policy needed to be clarified.

63 These should however be seen as an opportunity for the Organization to develop and PAHO should look to address these structural issues, and take this into consideration as it starts to overhaul its corporate information systems. We have highlighted below in paras 64 to 83 some of the more significant areas where we think PAHO could benefit from taking further action.

PAHO's Financial System

64 In our previous long form reports, we have raised our concerns about the dated finance system and we continue to re-iterate this. It is very important that the basic underlying accounting system has the capacity to capture information about how resources are actually being used, and has the ability to provide the necessary financial reports that meet both the requirements of IPSAS and the needs of management.

65 The year end preparation and auditing of the consolidated financial statements was a difficult process, with many areas of these statements being put together as part of an "off the system" one off exercise (identifying outstanding expenditures at the year end) or after specific "add on" IT programs were run to identify necessary adjustments (such as calculating depreciation on fixed assets).

66 Many of these changes were then made to the financial data in the system before it was suitable for financial reporting purposes. Consequently the year end financial reporting process is currently very dependent on key finance staff and manual calculations and adjustments being performed. This is an inherently risky situation with the reporting timetables susceptible to errors being made due to the significant level of manual intervention required.

67 The current financial database does not contain the full suite of reports expected from modern accounting systems. It cannot quickly produce reports on key balance sheet items. The Organization should be able to run, at any time, a full list of all outstanding amounts that are due to be paid (payables) where the goods and services have been received. Equally, the system should have the capability to generate a report that gives a snapshot of what amounts are due (receivables) to the Organization, when they are due and how overdue they are. These details not only mean that the information within the statements can be verified, but also that management are able to identify the likely cash inflows and outflows.

68 A fully functioning accruals based system should provide both a faster and automated closing of the financial statements (and a quicker audit) with minimal manual workarounds. This will in turn help build capacity among finance and administration teams and ensure that resources are not diverted from on-going finance and control activities

98 Developing the Benefits of IPSAS

69 This would help the Organization to produce fully audited financial statements to an earlier timetable, which may align better with the meeting dates of key governing body committees, such as the Audit Committee and the Sub-Committee on Program, Budget and Administration.

70 We note that at the 50th Directing Council, the Member States approved the acquisition, development and implementation of an Enterprise Resource Planning system. We understand the project will provide opportunities for the Organization to address its address the business processes associated with financial systems and the corresponding business and reporting needs.

71 Recommendation 4: We continue to recommend that the Organization makes the upgrading or replacement of the financial and management accounting system a strategic priority.

Expenditure Recognition

72 IPSAS requires that expenditures are reported only for goods and services that have actually been received in the year. This in turn involves an organization being able to identify, at any given point in time, the status of its ongoing activities and projects. These are often monitored on a monthly basis as part of the preparation of monthly management accounts.

73 However, PAHO does not yet have the systems or the management reporting processes in place to carry this out on a regular basis; the accounting system does not have the ability to record accruals for work that has been done but not yet paid for. Instead, the process of identifying what goods and services had actually been received in 2010 was carried out at the year end as a manual exercise carried out by staff.

74 Year end work undertaken by the external audit team identified examples of where projects had been cancelled or finished early, but the system did not reflect this. This led to further work which had to be done before the information was suitable for inclusion within the consolidated financial statements.

75 Recommendation 5: We recommend that PAHO consider how, both Headquarters and Country Office, staff should review and amend information in the system on a more frequent basis to ensure that the status of projects and expenditures is correctly reflected, and that management information is up to date.

76 Recommendation 6: We recommend improved monitoring and independent cross checking of the work carried out by both financial and non-financial staff who are responsible for updating the system to reflect the status of projects and contracts.

Employee Benefits

77 IPSAS requires the full recognition of liabilities that will fall due to the Organization because of the employee benefit arrangements that it offers its staff. To determine the value of the liability, the Organization appointed an independent qualified actuary to calculate the amount that is due.

78 This new information should be taken into consideration by PAHO and its Member States as part of PAHO's management of its human resources. It can be used as a basis to review the existing policies and processes by which staff are contracted and related benefits. Objective financial analysis provided by the actuary firm provides a good platform on which to make an informed judgement on staffing and resource strategies.

79 Recommendation 7: We recommend that PAHO and its Member States consider how to use the information it now has regarding its employee benefit liabilities in its management of human resources.

Intangible Assets

80 The year end closure process involved considerable discussion about what was the most suitable accounting policy for PAHO to adopt regarding intangible assets. Intangible assets are commonly assets such as software, licenses, or information databases that have value to the Organization and are used up over a period of time, which may be purchased or internally generated. Given that PAHO's Directing Council has authorized PAHO to proceed with modernizing its management information systems, effective management of intangible assets will become increasingly important. The majority of the costs of these assets will be external consultants and purchased software. These projects will consume a large proportion of permanent staff time, especially in the departments of Information Technology Services, Knowledge Management and Communication and Procurement where staff may be assigned to work exclusively or partially on these projects.

81 One of the key advantages of capitalising and reporting on these assets separately, is that the costs are fully transparent throughout their lifecycle, and subject to query by PAHO's oversight bodies. This is particularly important in complex IT projects during the development and design stage, where a significant risk is that costs of software and consultants time may increase beyond the original plan. It is important these project costs be managed carefully.

82 PAHO will need to make sure that it has a sufficiently robust project management framework in place including models which are able to identify staff time spent on specific pieces of work and to clearly attribute those costs that relate to them. This is not just to comply with the financial reporting framework, but will be necessary for senior management to effectively manage the implementation and understand the cost of high value and high risk projects.

83 Recommendation 8: We recommend that PAHO establish a clear project management framework to ensure that project costs can be clearly identified and accurately reported. This will assist senior management to oversee the roll out of PAHO's major software and IT development plans which commence from 2011.

Country Office Visits

Introduction

84 PAHO operates throughout the Americas and project implementation at a country level is managed by its network of Country Offices and Centers. This network is responsible for the direct administration of \$210 million of disbursed funds in 2010. This is a significant component of PAHO's reported activity and we carry out field visits to obtain assurance on controls over locally managed funds and expenditure.

85 Our selection of Country Offices is determined by a detailed risk assessment which takes account of the level of expenditure, the length of time since our previous visit and discussions with Headquarters staff. We also take into consideration the recent visits and findings from the Office of Internal Oversight and Evaluation Services, when we consider which Offices to visit.

86 During 2010, we visited the following Country Offices: Haiti, Dominican Republic, Brazil and Nicaragua. At the conclusion of each visit we have presented the management of the Country Office with our feedback, outlining any specific findings and recommendations. Management has been encouraged to respond accordingly and set out a clear action plan to implement or follow up on the points that we have raised.

Response to Disaster Scenarios

87 We visited the Haiti Office in September 2010. This was nine months after the earthquake on 12 January 2010 which destroyed a large component of the infrastructure in Port-au-Prince, the capital of Haiti. The damage was extensive and included PAHO's Country Office. PAHO immediately relocated and is now still operating out of the PROMESS warehouse site in temporary mobile offices.

88 The total expenditure of Haiti for 2010 was in the region of \$22 million of disbursed funds managed directly by the Office, with additional central emergency funds and funds at the Dominican Republic also being used to help the Organization respond to the crisis.

89 These allotted funds are significant in the context of PAHO's country operations, and were used to aid in the reconstruction of the country's healthcare systems. In the initial few months, PAHO's Country Office played a significant role in purchasing and distributing medical supplies and equipment to the local population and health care providers. This work was carried out in difficult circumstances, with limited financial systems, IT networks and poor communication links to Headquarters in Washington DC. The temporary office operated under emergency control procedures, with the PAHO Country Representative exercising a delegation of authority of \$100,000.

90 We recognise that the Country Office has operated in extraordinarily difficult circumstances during 2010 and that this has placed an exceptional pressure upon its administrative procedures and its staff.

Our work in Haiti therefore, involved testing internal systems and controls over procurement, payroll, banking and asset management. We selected a sample of individual transactions to verify that internal controls were operating effectively. In instances where we found control weaknesses, we increased the number of transactions tested so as to compensate for the increased level of risk.

91 Overall we concluded that the results of this visit were satisfactory and there were no matters of concern that would have a material impact on our audit opinion on the financial statements of PAHO. This is a positive outcome given the scale of the emergency, and the challenging situation that PAHO staff were operating in.

92 We provided detailed observations to the Country Office about areas where the financial systems could be strengthened. These covered the need to improve controls around the inventory managed by PROMESS staff, and those financed by voluntary contributions and donations, and to ensure policies and procurement procedures continued to be followed.

93 During the initial period following the earthquake, communication systems were poor and it was not easy to communicate between the Country Office and the Emergency Operations Center set up in Washington DC to help oversee the situation. This resulted in some contradictions between the Country Office and PAHO Headquarters as how best to address the situation on the ground.

94 There was an initial influx of consultants and health professionals being re-assigned to Haiti. While the additional technical expertise was welcome, this placed undue pressure on administrative and finance systems which did not have the capacity to absorb this extra volume of work. The Country Office was also needed to accommodate the extra staff and provide security arrangements. In particular, a number of staff who arrived did not have sufficient training or knowledge of the procurement process established by the Office. While this was unavoidable given the speed with which PAHO needed to respond, the overall response should be critically evaluated to determine both positive achievements and areas that could have been done better. This should be fed back to relevant staff, and emergency response plans developed accordingly.

95 Recommendation 9: The Organization should fully analyze the response with the key individuals involved, to fully understand the situation and produce a paper to clearly highlight the lessons learned.

Decentralization of Control

96 The Brazil Country Office is responsible for large and diverse geographical regions, and during our audit visit, we observed a tendency to devolve internal controls away from the center. In these situations, responsibility for procurement, administration and budget management has been devolved to individual areas of programme activity, supported by a central team who provide oversight and guidance. Although the de-centralization of this expertise has the advantage in allowing teams to respond quickly to circumstances and situations on the ground, this also gives rise to particular risks which need to be managed carefully.

102 Country Office Visits

97 This risk materialized during the year end closure process by which the Country Offices were asked to help implement the new expenditure recognition policy under IPSAS. One key step of this new policy was that Country Office finance staff were asked to review all open obligations and disbursements during the year, and determine which amounts related to goods and services received in 2010 and which were to be delivered in 2011. This information was sent back to the central Finance team in Headquarters and used as the basis of annual expenditure and accrual balances in the consolidated financial statements for the year ending 31st December.

98 During our visit, we performed a detailed check on this exercise, and found a number of discrepancies between what is required by IPSAS and what was submitted as part of the year end closure. Despite considerable training and instruction provided, it was not clear that staff fully understood the accounting principles behind the exercise they were asked to carry out and a number of errors were made that needed to be subsequently adjusted.

99 In these cases much of the responsibility to carry out the work had been passed on to wider teams working in the Country Office, and this may be why many did not fully understand the nature of the exercise. However, it is important that where responsibility for key financial activities is devolved, an effective system of checks and balances are put in place to mitigate against the risk that this is not carried out correctly. These checks and balances should be underpinned by clearly documented processes and procedures which are available to all staff, and which are aligned with central procurement guidance produced.

100 Recommendation 10: We recommend that PAHO assess the Country Office structures in Brazil where some financial controls were devolved to technical units and put in place a process of checks independent of the Office to ensure controls are operating effectively. These can be on a sample basis and focus on areas of the operation deemed to be of greater risk.

Corporate Governance

Introduction

101 Effective governance arrangements are essential for Member States to obtain the necessary oversight of any international organization. The Executive Committee is given the responsibility to provide this oversight and there are a number of mechanisms on which they rely to obtain this assurance. PAHO has demonstrated a very positive approach to strengthening the corporate governance of the Organization.

102 As part of our audit we have considered these arrangements and have considered their development. Where necessary we made a number of observations on how these governance mechanisms can be enhanced.

Statement of Internal Control

103 International organizations are increasingly adopting best practice by providing a Statement on Internal Control (SIC) within their annual financial statements. A SIC is an accountability document that describes the Director's assessment of the effectiveness of internal controls and the assurances on which the assessment has been based. The adoption of a SIC enhances accountability and transparency of the management and control over resources.

104 In our prior year report, we recommended that PAHO should produce such a Statement to be published alongside the 2010 consolidated financial statements. We are pleased that the Organization has taken this recommendation forward and produced one this year. In particular, we would like to draw the attention of Member States to the significant control issues identified and what actions are being taken to address these issues.

105 It is important that these issues form the basis of grounds to oversee the ongoing risk management of the Organization for the relevant governing bodies and committees to encourage a degree of constructive challenge as to the adequacy of PAHO's responses to the significant issues identified.

106 Although we are not required to produce a specific opinion on the SIC, we would usually report any material inconsistency between the Statement and our own assessment of the internal control environment. We can confirm that during the course of our audit, we did not identify any other significant control weakness that we think should have been included in this Statement.

The Audit Committee

107 PAHO has continued to make good progress on our earlier recommendations around the establishment of an Audit Committee with three fully independent members appointed through an external recruitment process. The first meeting was held on 5 November 2010 where the Committee elected its Chair and was given a full briefing on the background and activities of PAHO and some of the aspects of the Organization that are considered significant to senior management.

108 The Audit Committee met in March 2011 to consider a range of topics, such as the planning processes, the financial information for 2010 and the internal and external audit functions. We were invited to participate as observers when the consolidated financial statements were presented, and we were able to make comment if we wished and respond to any questions.

109 Consideration of the financial statements and a draft audit report is not included in the Audit Committee's Terms of Reference. Our view is that the Audit Committee could usefully have a role in considering the financial statements, the audit completion report, and the draft audit report. However, this would require a change to the terms of reference and may be something PAHO and its Member States wish to consider for the future. However, we should stress that the current timetable does not allow for this, and would need to be considered in any changes made, in conjunction with the external auditors.

110 Recommendation 11: We recommend that PAHO and the Audit Committee continue their work in embedding the Committee, and periodically consider the effectiveness of the Committee and its Terms of Reference.

Office of Internal Oversight and Evaluation Services

111 The Office of Internal Oversight and Evaluation Services Office (IES) represents a key element of internal assurance and good governance. It ensures that an effective control environment is maintained; and provides advice to management on how it can be strengthened. This work supports the assertions made by the Director in the Statement on Internal Control. It also informs our audit approach and assists us in identifying key risk areas, so as to concentrate our efforts.

112 In our previous report we noted that PAHO has been making progress in resourcing the Office, finding a permanent Auditor General, and supporting the IES through the use of short term consultants and temporary staff. The Office has strengthened its staff resources, and now has filled the majority of its posts with fixed term staff, with one vacancy for which recruitment is in progress. This is a positive development and will ensure that knowledge of the Organization and its processes remains internalised and is not lost as staff move off the assignment.

113 The work plan of IES is based on a documented risk assessment of the Organization. IES completed 14 out of 15 planned assignments for 2010. We used this work to inform the direction of our own audit, helping us to identify areas of concern for our audit opinion that may need to be followed up. We continue to work with the IES to identify areas where we can rely on their work to avoid duplication of effort.

114 IES produces a formal annual report each year which is presented to the Executive Committee and the Director. The Audit Committee is also provided with a draft of this report and asked to provide any comments that it may have. The IES function is a key component of effective governance of the Organization. It is important that the risks and concerns identified in the annual report are noted by the Organization and steps are taken to address these.

Enterprise Risk Management

115 In previous External Auditor's reports, we have emphasised the importance of effective risk management and that an internal control system should include a risk register which: identifies the risks; the areas affected; and sets out the proposed mitigating action, taking into account existing controls and responsibilities. We highlighted the need for the risk register to be underpinned by robust procedures which ensure that all staff and key stakeholders, including the Audit Committee, are fully engaged in the process.

116 PAHO has made progress with this and have acknowledged the value of Enterprise Risk Management (ERM) to the Organization. An Enterprise Risk Management Framework document has been prepared and PAHO is taking forward the development of a system of ERM.

117 Recommendation 12: We welcome PAHO's developments in this area and recommend that PAHO continues its development of Enterprise Risk Management.

Follow up to previous audit recommendations

118 In our report for 2008-2009, we made a number of recommendations on financial matters in relation to the implementation of IPSAS, the need to put in place new financial accounting systems, better business continuity planning and risk management, and recommendations around the internal control environment, and governance arrangements over the Staff Health Insurance Fund. As part of our work we have followed up the progress that PAHO has made in implementing these. The detailed follow up, including both the response from PAHO and our comments thereon, is set out in Annex B.

119 Overall we are of the opinion that PAHO has responded appropriately to our previous recommendations and are taking steps to address the issues raised. We concluded that PAHO has responded positively to our recommendations regarding the IPSAS and improvements to internal controls and the accountability framework, such as the publication of a Statement on Internal Control. A number of these responses have only been partially implemented to date as they are currently in progress. A number of these issues still, in our view, need to be addressed as a matter of priority. Where these continue to be of significant importance, for example the dated financial accounting system and the need to have clear project risk assessments at the outset, we have repeated these in this year's report.

Acknowledgement

120 We wish to record our appreciation for the co-operation and assistance provided by the Director and the staff of the Organization during the course of our audit.



Amyas C E Morse

Comptroller and Auditor General, United Kingdom

External Auditor

14th April 2011