

Report of the External Auditor

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National Audit Office

REPORT TO THOSE
CHARGED WITH GOVERNANCE
April 2012

Pan American Health Organization

Long Form Report on the 2011 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 2011 consolidated financial statements which present fairly, in all material respects, the financial position and the results of operations and cash flows for the financial period ended 31 December 2011; 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 2011 consolidated financial statements of the Pan American Health Organization (PAHO) represent the second year that the International Public Sector Accounting Standards (IPSAS) have been used. For the first time, therefore, comparatives are provided and a more complete and comparable set of balances is available to the users of the statements. Revised internal controls to allow for effective accruals accounting worked more effectively in 2011 than in the year of transition. An unqualified opinion therefore reflects the continuing hard work and effort to embed these processes within the business and the Organization is to be commended for this achievement. Whilst we recognise there remains further room for improvement, 2011 represents a year of progress by PAHO.

3 As noted in 2010 PAHO have begun to capitalise on the achievement of implementing IPSAS and have used this momentum to effect additional changes to the current work practices, however further opportunities still exist, with the implementation of an Enterprise Resource Planning (ERP) system which should increase integrated working across the Organization.

Overall Results of the audit

4 We have audited the consolidated financial statements of PAHO in accordance with the Financial Regulations and International Standards on Auditing.

5 The audit opinion confirms that these financial statements: present fairly, in all material respects, the financial position as at 31 December 2011 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.

6 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

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.

7 The main observations and recommendations from our audit are set out below. Our recommendations are summarised in Annex A. Actions taken by management in response to our 2010 recommendations are set out at Annex B.

8 The 2011 financial statements represents the final year of the NAO's appointment as the external auditor of PAHO. We will follow the United Nations protocol for hand over arrangements to our successors, the Spanish Court of Audit (Tribunal de Cuentas). We would like to thank PAHO for their professional and constructive approach to the external audit relationship over the many years of our engagement. PAHO's management have consistently engaged with the audit process and have sought to improve processes and procedures in response to our audit recommendations.

9 We recognise the considerable progress made by PAHO during this time, with particular regard to the development of an effective control environment including a well-developed corporate governance structure that includes: an effective internal audit function; an established Audit Committee; improving risk management processes; and positive interaction with external auditors. PAHO have also successfully managed the transition to accruals based IPSAS financial statements. The latter has been extremely challenging due to the limitations of PAHO's financial reporting systems and the need to implement revised financial procedures across a geographically diverse business area. This success owes much to the efforts and dedication of PAHO staff, who have succeeded in implementing IPSAS in advance of many larger international organisations. The adoption of IPSAS has necessitated staff training which on the whole has been effective.

Summary of Main Findings

10 In this report we have commented upon the Organization's financial position; governance matters; our findings with respect to Country Offices and the current status of the PMIS ERP project. We have made recommendations aimed to improve the effectiveness of the Office of Internal Oversight and Evaluation Services by the introduction of performance measures for IES; strengthening of information systems audit resources and through encouraging PAHO management to respond more quickly to IES recommendations.

11 On Country Offices we have noted that the internal control environment across the country office network as a whole is adequate but have drawn attention to continuing problems embedding a full understanding of the IPSAS accruals concepts as well as instances of non-compliance with procurement regulations. We have recommended that PAHO take action to reinforce the understanding of IPSAS accruals concepts and to ensure that single source procurements are minimised and the reasons for resorting to such procurement actions are properly documented.

12 Our review of the PMIS project identified that although much good work had been completed, some slippage in the project pre-implementation phase had occurred in that the software package and system integrators had not yet been selected. The report also draws attention to the absence of a number of key deliverables. In particular we note the absence of a comprehensive and well-articulated business case for the project which clearly sets out the business need, costs and measurable benefits which are expected to result from the project. Similarly we have recommended that the project team complete key documents

which were envisaged during the pre-implementation phase including a detailed set of project plans and change management and communication plans. We have also highlighted the need to introduce a comprehensive risk management approach including a risk register for the project.

Financial Review

Overall Summary of Results

13 The Director's Comments on the Financial Statements provide a comprehensive analysis of the financial performance of the Organization for 2011. We review the financial analysis provided for consistency with the information contained in the consolidated financial statements and offer some further analysis to aid users.

14 From our audit of the consolidated financial statements we have identified a number of matters that we consider it appropriate to highlight in this report:

- The results for the year showed a small net surplus of \$2.153 million.
- At the period end there are sufficient funds available to meet reported liabilities as they fall due. While cash balances have decreased from \$167.6 million in 2010 to \$104.7 million at 31 December 2011 (a reduction of some 37% between financial years), this has been more than offset by an increase in short and long term investments. Total funds invested increased from \$316.9 million in 2010 to \$488.9 million at 31 December 2011. This represents an increase in investments of some \$172 million (54%) between years. The financial statements disclose that PAHO's total assets exceed total liabilities by some \$132.5 million.
- While the reported net current and non-current liabilities for employee benefits disclosed on the face of the Statement of Financial Position have reduced by some \$5.2 million from the prior year, it should be noted that the estimated underlying net liability in respect of employee defined benefit obligations has in fact increased. The most recent actuarial valuation reported that the estimated liability for these increased by \$22.1 million from \$233.4 million in 2010 to \$255.5 million in 2011 (note 12.3.4 refers). As reported in the 2010 external audit report there remains a need for PAHO to consider how best to fund these long-term liabilities as they fall due. I commented extensively on this subject in my 2010 report and further comment on this area can be found in Annex B concerning the follow up of previous audit recommendations.
- The Financial Statements also disclose (note 6.1.2 refers) a 145% increase in the balance of voluntary contributions receivable at 31 December 2011 compared to 2010 from \$80.1 million to \$196.8 million at the end of 2011. This reflects an increase in short term voluntary contributions

receivable, primarily from one major donor. While such an increase reflects confidence in PAHO to be able to deliver an increased programme of voluntary funded activity it will place increased pressure on the capacity of the Organization and will require careful management to ensure that cash flows are available to match the activities performed. In addition, PAHO should seek contributions in US Dollars to minimise exposure to adverse movements in exchange rates. Failure to manage these risks carefully could place pressure on cash flow management and result in significant losses on exchange rate movements.

- Revenue from most sources has remained stable between years, however, there are two exceptions to this; the revenue relating to the procurement of public health supplies fell by 16% from \$541.2 million to \$455.9 million due primarily to the reduced purchase of H1N1 vaccine which has now been combined with the vaccine for seasonal influenza. Miscellaneous revenue also reduced by 71% from \$5.2 million to \$1.5 million. It should be noted that procurement revenue relating to the purchase of vaccines and equipment is demand led and PAHO therefore has only limited control or influence over these revenue streams.
- A similar pattern can be seen within the expenditure incurred in 2011. There has been a reduction in the purchase of vaccines and equipment reflecting the fall in revenue. However there have been other movements, including a decrease in staff and personnel costs of 5% or \$8 million as a result of a reduction in the numbers of international and national staff employed. However, as numbers of international and national staff have reduced there has been a significant increase in the use of contractual services, which have increased by 27% from \$84.1 million to \$106.6 million.
- 2011 is the first year in which PAHO have recognised intangible assets on its Statement of Financial Position. An intangible asset may be defined as “an identifiable non-monetary asset without physical substance”. Examples of such assets include intangible resources such as computer software, licences or patents. In 2011, PAHO has capitalised approximately \$2 million of intangible assets relating to internal investment in information systems and software, with \$1.4 million of these assets currently in the development phase.

Country Office Visits

Introduction

15 PAHO operates throughout the Americas and its project implementation at a country level is managed by its network of Country Offices and Centers and funds its operations using regular budget allocations as well as project funds. The cumulative disbursements by these Offices in 2011 was \$199 million (2010: \$210 million) which 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.

16 Our selection of Country Offices is determined by a 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.

17 During 2011, we visited the Brazil and Argentina Country Offices. At the conclusion of each visit we presented the management of the Country Office with our findings and recommendations. Management has been encouraged to respond and set out a clear action plan to implement or follow up the points that we have raised. This was the second consecutive year that we have visited the Brazil Office but we considered this to be necessary because this Office is responsible for the largest proportion of PAHO's expenditure, apart from Headquarters, and we found a high level of errors in the reported accrued expenditure during our 2010 visit.

Identification of accrued expenditure

18 Under International Public Sector Accounting Standards (IPSAS), entities are required to recognise expenditure in the financial statements when it is incurred i.e. when the goods or services have been received. To identify the value of the expenditure incurred in 2011, relevant finance staff from around the Organization are required to review all open obligations and disbursements during the year and determine which goods and services were delivered in 2011 and how much was due to be delivered in 2012. Accrued expenditures are considered a significant risk area as it requires a clear understanding of the accruals concept and was an area that had proved to be challenging in 2010.

19 Our testing in the Country Offices in both Brazil and Argentina again identified errors in the reporting of accrued expenditures by these Offices. We found a number of transactions where amounts had been reported as expenditure in 2011 even though the goods or services had not been received and were therefore due to be delivered/received in 2012. However, we noted that the level of error detected in 2011 was significantly lower than in 2010 and there was an improvement in the quality of documentary evidence from implementing partners to support accruals. This improvement reflects efforts made by FRM

to provide additional training and support to Country Offices. Furthermore, in the case of Brazil, PAHO contracted a private sector accounting firm to perform a detailed review of the accrued expenditure. However, while the improved control over accrued expenditures is welcomed it is clear that errors are still occurring and there remains a lack of understanding of the accruals accounting principle in parts of the Organization.

Recommendation 1: We recommend that PAHO continues to impress upon key staff across the Organization the importance of understanding the accruals concept and obtain complete and relevant evidence to support the level of accrued expenditure reported at the year end. PAHO should also consider further strengthening their internal review procedures in view of the errors which continue to be made.

Internal controls

20 Over the years of our engagement as the external auditor of PAHO, we have made many observations about the effectiveness of the operation of internal controls at the Country Offices and Centers. The observations have had similar themes in the past and this continues to be the case in 2011. For example, we have made observations regarding the importance of bank reconciliations and tendering processes.

21 In respect of bank reconciliations, we made minor recommendations that long standing reconciling items should be investigated and resolved as soon as possible. In terms of procurement procedures, we noted that often short term contractors are contracted to work on specific projects without the positions being advertised under open competition procedures, and without sufficient evidence being retained to explain why the non-tendering of the position was appropriate.

22 Our findings corresponded with those of IES during 2011. From its Country Offices and Center visits, IES have reported on the internal control weaknesses observed. These included the need to improve the quality of the evidence retained on file in respect of procurement and expenditure and evidence of expenditure authorisation to demonstrate that segregation of duties were being observed. In addition, IES observed the need for staff to adhere to PAHO procurement procedures e.g. tendering procedures, and the rules over the use of Letters of Agreement, for example, Letters of Agreement should not be used for construction projects.

23 It has also become apparent from our Country Office visits, this year and in past years, that PAHO procurement procedures are not always followed in the Country Offices.

Recommendation 2: We recommend that PAHO puts measures in place to ensure that staff throughout the Organization comply with laid down procurement procedures. This will ensure that PAHO makes the most effective use of its resources and receives value for money from its purchases. Particular emphasis should be placed on ensuring Letters of Agreement are used appropriately and on the prevention of single source tendering. Where single source procurement is used the reasons for such action should be clearly documented.

Governance Matters

24 Effective governance arrangements are essential for Member States to obtain the necessary oversight of any international organisation. 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. As part of our audit we have reviewed these arrangements and have considered their development.

Enterprise Risk Management

25 During 2011 PAHO initiated a project to create a risk management framework based upon ISO31000, a set of internationally recognised standards, which provide principles and guidelines on risk management. A conceptual framework for the risk management strategy was approved and a Senior Risk Management Committee was established in November 2011. A risk management policy document has also been drafted.

26 Previous audit reports have emphasised the importance of effective risk management and in particular 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.

27 Risk registers should be underpinned by robust procedures which ensure that all staff and key stakeholders, including the Audit Committee, are fully engaged in the process.

28 With the aid of voluntary funding, PAHO have purchased and installed an Enterprise Risk Management Information System to help embed the new policy, which was implemented in December 2011. As part of the initial phase of implementing the office wide risk management system, pilot exercises have been conducted in two Country Offices and in relation to Procurement Funds and Revolving Funds. Some training workshops have also been provided to a small number of staff.

29 Management plan to optimise the use of the risk management software by providing training to all staff, with the publication of the first consolidated risk register due in spring 2012. Risks will then be prioritised through the use of a number of risk maps. A draft Enterprise Risk Management handbook has been produced and is to be finalised and issued by 30 June 2012. It is the intention that 50% of all PAHO units will have been subject to risk assessments by the end of 2012 with the remaining 50% of units covered by the end of 2013.

30 Our review of the risk management system installed confirms that it contains the key elements required to effectively manage and mitigate risks. The review also confirms that considerable progress has been made in a relatively short time, however, the system is in the early stages of implementation and

some key automated aspects of the system have not yet been activated (for example automated alerts to prompt action by risk owners). The Risk Management Committee has not yet met and the system as a whole is not yet mature enough to assess the extent to which it will meet the needs of the Organization in practice.

31 We note also that the implementation of the system currently relies heavily upon the efforts of one key member of staff and that although some risk “champions” have been designated to help embed the risk management concepts, it is not clear whether the existing level of resources devoted to the project will be adequate as the system is rolled out across the entire Organization.

Recommendation 3: PAHO’s investment in developing a risk management framework is welcomed and we recommend that progress be reviewed against the project target dates to ensure that it is embedded within procedures and the culture of PAHO as soon as possible.

Recommendation 4: We further recommend that PAHO review the resources devoted to the implementation of the system to ensure that they are adequate to cope with the future roll out, and that the successful implementation and maintenance of the new system is not over-reliant on the efforts of one key member of staff.

Office of Internal Oversight and Evaluation Services

32 Financial Regulation 12.1(d) states that the Director of PAHO shall “maintain an internal audit function which is responsible for the review, evaluation and monitoring of the adequacy and effectiveness of the Organization’s overall systems of internal control. For this purpose, all systems, processes, operations, functions and activities within the Organization shall be subject to such review, evaluation and monitoring”.

33 Under the IES Charter, the Office of Internal Oversight and Evaluation Services (IES) is a key component of internal control and assurance within PAHO and provides internal auditing and evaluation services. The scope of their work covers the provision of assurance regarding risk management, control, and governance processes to the Director of PAHO. Under their Charter, the scope of IES activities includes “ascertaining that the Organization’s assets are safeguarded; that activities are conducted effectively, efficiently and economically in accordance with internal policies, rules and regulations; that information is accurate, secure and reliable; and that adequate measures have been taken to prevent fraud, waste, abuse and mismanagement. By carrying out this function IES provides management and external stakeholders alike with independent assurance that the Organization’s risks have been appropriately mitigated”.

34 We have conducted a review of the work of IES to assess the extent to which we can rely upon it and in particular we have examined the independence of the Auditor General; the scope of his work; the adequacy of resources devoted to IES and the adequacy of responses to the Auditor General’s recommendations.

35 The Charter for IES assures the independence of the Auditor General by providing for direct reporting to the Director of PAHO and we have confirmed that he has exercised this facility. The Auditor

General also has direct access to the Chair of the Audit Committee and has also exercised this right during “in camera” sessions with the Committee. Similarly, we consider that the scope of the IES mandate as set out in the Charter, and as evidenced by the work programme and plans of the unit, is adequate and commensurate with the needs of the Organization.

36 We have noted progress in previous years in the resources allocated to IES and in 2011, IES had personnel resources of six fixed-term posts and one short-term position, which the Auditor General considered adequate to implement the IES Work Plan. All but one of IES’ fixed-term posts were occupied in 2011, and the final vacant post was filled in January 2012. It has also been noted that in 2011, IES’ funding was sufficient to cover necessary expenses, and no aspects of IES’ work were either curtailed or deferred for funding reasons. We encourage PAHO to maintain this level of support and funding for its internal audit function going forward. We note however that IES do not possess strong Information System audit skills.

Recommendation 5: While such expertise can be contracted in for specific assignments we recommend that IES review its staffing profile and consider whether it requires further specialist information systems audit resources. Such skills may be of particular added value in future as PAHO begin the implementation of a new ERP system.

37 In reviewing the work of IES we noted that the work plan of the unit is developed with reference to the strategic objectives of the Organization and adopts a risk based methodology as far as possible given the limited risk management procedures currently in place within PAHO. The audit plans are also subject to consultation with management, external audit and with the Audit Committee and are approved by the Director. Our review has confirmed that in 2011 they delivered the approved programme of work broadly as planned and that their recommendations were accepted by management. We note however that the unit has not established a set of performance indicators or measures by which its performance can be objectively assessed.

Recommendation 6: We recommend that IES develops performance indicators to measure how well they perform against their annual audit plans and over time. Examples of such measures include: the proportion of audit recommendations accepted by management; the number of recommendations implemented within a given timescale; financial savings generated as a result of audit recommendations; the costs of reports delivered compared to planned costs; and the number of reports delivered compared to those planned. IES need to develop measures which are specific to their and PAHO’s circumstances.

38 In keeping with best practice, IES established a mechanism for following up its recommendations and provides a quarterly report on implementation to the Director. Progress reports are also submitted to the Audit Committee along with results of their individual audits and evaluations. IES also produces a formal annual report each year which is presented to the Director, Executive Committee and the Audit Committee.

39 The 2011 IES Annual Report presented a summary of the implementation of their recommendations over the period 1 January 2006 to the end of 2011 which shows cumulative implementation rates since 2006 in the order of 85%. We note however that IES considers the implementation rate to be rather slow, which is supported by the 35% implementation rate in 2011 and the fact that some 25% recommendations raised since 2008 remained unimplemented at the time of the Auditor General’s report. We consider that

there is considerable scope to improve the implementation of IES recommendations and understand that IES is discussing with management how best to achieve this.

Recommendation 7: We recommend that management take action to improve the implementation rate of IES recommendations as a matter of priority so that IES can “add-value” in the timeliest manner.

40 We note also that IES’ overall opinion on the adequacy of internal controls is consistent with our own, and that PAHO’s internal control environment is considered adequate to provide reasonable assurance that transactions and activities are authorised and properly recorded.

Accounts Production Process

41 It is essential that the financial accounting system has the capacity to capture information about how resources are used, and has the ability to provide the financial reports that meet both the business needs of the Organization and the basic requirements of IPSAS accruals accounting.

42 The existing information systems employed by PAHO are unable to support the needs of IPSAS based financial statements and a number of manual and time-consuming “workarounds” are required to compile the accounts. Consequently the year-end preparation and auditing of the consolidated financial statements remains a complex and difficult process, with many areas of these statements being compiled “off the system” through a one off exercise (identifying outstanding expenditures at the year-end) or after specific “add on” IT programs are run to identify necessary adjustments (such as calculating depreciation on fixed assets).

43 The limitations of the current systems mean that year-end financial reporting process is highly dependent on key finance staff and manual calculations and adjustments being performed. This is an inherently unsatisfactory process which inevitably increases the risk of errors being made due in the accounts preparation and of delays to the accounts preparation and audit process. The planned implementation of a new ERP financial accounting and information system should address the weaknesses noted.

Development of an Enterprise Resource Planning (ERP) System

Background and Scope

44 In 2008 the 48th Directing Council authorised the use of funds from the Holding Account to perform analysis, study options and issue recommendations for modernising the Pan American Sanitary Bureau (PASB) Corporate Management System, now known as the PASB Management Information System (PMIS) Modernisation Project.

45 The PMIS Committee consulted key stakeholders and staff within PAHO before producing a set of Principles to guide the modernisation process. The Committee also oversaw the review and analysis of PAHO's Business Processes and analysed Options and Costs before concluding that an ERP system was the most appropriate way to meet PAHO's modernisation needs. This recommendation was approved by the 50th Directing Council (2010).

46 A project budget for PMIS of \$20.3 million was subsequently approved, this cost estimate having been based upon costs of a similar ERP implementation by a sister UN Agency adjusted to fit PAHO's circumstances. At the time of writing this report, PAHO had spent approximately \$1.1 million against this budget.

Project Scope

47 On 8 June 2011 the Director formally announced the launch of the PASB Management Information System (PMIS) Modernisation Project for installing the Enterprise Resource Planning (ERP) software for use by the whole of PAHO. The scope of the project covers entities at all levels: regional; sub-regional; and country, and includes:

- Program Management,
- Budget,
- Human Resources and Payroll,
- Finance, and
- Procurement.

48 At the time the project was approved the following timetable was envisaged:

- 1) Pre-implementation Phase - (June 2011 – mid 2012). This was to include: project preparation and elaboration; major procurements (ERP software and system integrator); refinement of business processes; and preparation of data (including identification of missing data, identification of duplicate data and evaluation of data quality).
- 2) Implementation Phase – (mid 2012 – mid 2014). Project management and implementation of the new system in all major business areas.

Project Goals

49 The overall goal of the project is considered to be three fold¹:

- a) An improvement of PAHO's processes, supported by the implementation of an integrated ERP software solution while maintaining necessary integration with WHO's Global Management System (GSM);
- b) The decommissioning of current systems; and
- c) Considering operational recommendations following three months of post-implementation operations.

Project Governance Structure

50 In order to ensure the success of the ERP implementation there needs to be a clear and effective governance structure in place. PAHO have instituted a governance structure which comprises internal steering and advisory committees as well as providing for independent external oversight.

Steering Committee

51 The PMIS project is guided by a senior level Steering Committee consisting of the Deputy Director, Assistant Director and Director of Administration, with the Deputy Director acting as chair. The goal was for the Steering Committee to meet monthly, however as the project has gathered pace this has occurred as frequently as weekly. Our review has confirmed that the Steering Committee has taken an active role in managing the project.

Advisory Committee

52 Supporting this group is an Advisory Committee whose members are the major business process owners, which include the Area Managers of Planning, Budget and Resource Coordination (PBR), Human Resources Management (HRM), Financial Resources Management (FRM), Procurement and Supply Management (PRO), General Service Operations (GSO), Information Technology Services (ITS), External Relations Resource Mobilisation and Partnerships (ERP), Knowledge Management and Communication

¹ Terms of Reference – PASB Management Information System (PMIS) Modernisation Project

(KMC) and Country Focus Support (CFS), as well as PWR-Brazil and PWR-Guyana in representation of the member states. However at the time of writing this report the Advisory Committee had only met officially once, though key members of the Committee had been involved in the process to date, being present at the testing of software providers, for example.

53 The purpose of this Committee was to represent stakeholders' interests, provide leadership and support to the project in their relevant areas and to provide guidance on business goals and success criteria, aligning the project to the business and guidance on policy issues and changes to policy raised by the project. However this group have only met once since the project began, which calls into question the effectiveness of communications with and involvement of key stakeholders who are key to meeting the overall objectives of the ERP system.

External Oversight

54 Throughout the PMIS project PAHO have sought objective advice from external sources. To this end they have employed a contractor whose role it is to evaluate the overall direction, risks and decision making of the project on a regular basis and to recommend changes as appropriate. This oversight is designed to help ensure that the project retains a focus on supporting the delivery of Technical Cooperation and adheres to project management best practices.

55 External advice has also been sought from consultants who have been engaged to advise on the original project approach (June 2010), to assess PMIS project readiness (August 2011) and most recently, in March 2012, to facilitate a workshop enabling stakeholders to discuss wide-ranging issues affecting ERP projects including lessons learned from other projects and ERP implications for PAHO. The focus of this workshop was to arrive at key decisions related to PAHO's system modernisation project, including vision, success factors, and business models, with the consultant working extensively with internal staff. At the time of writing this report the outcome of the workshop and the proposed response were still under consideration by management.

Audit Review

56 In view of the projected cost and strategic importance of the PMIS project to PAHO, and the known difficulties commonly experienced with major IT projects in UN and international public sector organisations in general, we have performed a high level review of the project during this pre-implementation phase. During our review we have sought to assess the progress made and to identify any significant risks to its successful implementation. We performed our review by examining relevant project documentation, external reports as well as by interviewing PAHO officials.

57 In carrying out our work we have drawn on the experience of other organisations, and have looked for evidence that PAHO is following best practice and lessons learnt elsewhere. Where ERP's have been successfully implemented, the following features, amongst others, have been observed:

- Commitment and buy-in from senior management to one coherent vision, resulting in effective leadership with one common voice. It is important that there is clear, executive level support for the project, and that this support continues throughout the project;
- Clear, agreed goals and objectives. The business processes that need to be supported, and the requirements that the system needs to meet have to be specified. The way that the business

processes are going to be aligned with the best practice model embedded in the ERP system needs to be identified. The measures for determining success should be laid out at the start of the project and be agreed by the system stakeholders;

- Strong project and programme management underpinned by detailed project plans, clearly defined and designated project resources, including staff resources, and careful monitoring of progress, risks and other issues affecting the project timetable and costs;
- Effective change management and integration of the new ERP with retained business information systems. Change management is crucial and it is imperative that changes are appropriately managed on two levels. First, there are the changes to the Organization. Second, there are the changes that are made to the programme of implementation of the ERP system (which will be part of the larger organisational change project);
- Careful selection and management of consultants and employees to implement the ERP. The project team needs to be made up of the people who are best suited to the job of implementing an ERP system, and ideally have experience of doing so; and
- Timely and effective training of employees with ongoing support in the early implementation period. ERP systems invariably change the way that people work throughout the organisation, so it is important that the users are educated about the changes, and trained to use the new system.

Audit Findings

Overall Project Status

58 At the time of writing this report we found that considerable effort had been put into producing a number of important outputs such as a Project Charter, high level project plans and documentation on PAHO business processes. We are also aware of strong management commitment and executive support for the project. The PMIS Steering Committee, chaired by the Deputy Director, has been very active and has met frequently to discuss a range of important issues. Potential ERP software platforms and integration partners have been shortlisted and consideration is being given to identifying staff from across PAHO who could be made available to work on the project execution and implementation phase.

59 However, some key elements of the pre-implementation phase had not been delivered as planned. For example, although two preferred software suppliers have been identified and a number of system integrators have been shortlisted, a final decision in these areas was yet to be made. Under the original project schedule the selection of the software package and the integration partner was due to be resolved by the end of 2011. Similarly, although project staffing is under consideration there is only a very small project management team in place at the time of writing this report. In selecting staff to work on the project it is also unclear how the posts will be adequately backfilled to enable the Organization to carry on “business as usual” at the same time as developing the new ERP solution.

Clarity of goals and objectives

60 The PMIS project set out a rationale for modernising PAHO's business processes. The adoption of an ERP based solution was deemed to be the most effective way of achieving the objectives of the modernisation project and it was on this basis that the project was approved. However, a fully articulated business case supporting the need for an ERP and the related costs and benefits has never been produced.

61 The Project Charter noted that more work needed to be done to define the business need for the project but it has not yet been completed. Similarly, there are no measurable performance indicators or targets, or any defined success criteria in place which could be used objectively to assess whether the ERP solution does in fact deliver the expected benefits. In the absence of a clearly articulated business case and established metrics for gauging the success of the project there is a risk that PAHO will not optimise the benefits from implementing an ERP solution and that the costs may in fact outweigh the benefits.

Recommendation 8: We recommend that a fully articulated and detailed business case in support of the ERP project is formulated as soon as possible. The business case should state clearly the business need for the project together with the costs and benefits it is expected to generate.

Project Management

62 In the pre-implementation phase of the project there has only been one full time person devoted to managing day to day project activities. This is a small project team for a project the size of PMIS and will need to be kept under close review as the project moves closer to the execution and implementation phases.

63 Our review of the project plans and timetable found that they are documented only at a high level. The detailed lower level activities which must be performed to achieve the higher level project milestones and target dates have not been specified or incorporated into detailed project plans. It is not therefore possible to identify a "critical path" for the project or to assess the overall effect on the project timetable of the slippage that has already occurred.

64 Similarly, there has been no attempt to validate or update the original budget set for the project. As the original project budget was estimated on the basis of the experience of a sister agency there must be a degree of uncertainty around the reliability of the estimated costs. This uncertainty is exacerbated because the \$20.3 million project budget currently excludes provision for a number of costs which it is intended will be funded and managed outside of the main project. Costs currently excluded from the main project budget include:

- General office support for the Project Office;
- Outside assistance with project oversight and risk management;
- Business continuity of the ERP hardware and software environment; and

- Operation and support of the system beyond the first 3 months following implementation.

65 The total cost of ownership of the ERP system has not therefore been calculated. In addition, the budget itself was set some time ago.

Recommendation 9: We consider that significant uncertainty is attached to the current project budget and recommend that it be re-examined in more detail. The full estimated costs of implementing the ERP solution in PAHO should be calculated including the costs of elements currently excluded from the approved project budget. In the future, project budget and forecasts should be regularly updated and reported to management on a periodic, preferably monthly, basis.

Change Management

66 As noted above, ERP projects such as PMIS require significant organisational change as staff must get used to new ways of working if the full benefits of an ERP solution are to be realised. Considerable costs can be incurred post-implementation if the changes associated with an ERP implementation are not identified and carefully managed from the outset. We found also that the pre-implementation phase of the project was intended to allow time for the preparation of detailed change management and communication plans as well as beginning the process of defining refined business processes.

67 We found that very little progress had been made on these important elements at the time of our audit review. Given the important changes that will be associated with the ERP solution and the planned modernisation of PAHO's business systems, the absence of well-defined change management plans poses a considerable risk to the success of the project.

Recommendation 10: We recommend that comprehensive change management and communication plans are drafted as a matter of priority. Similarly, work needs to be completed on the definition of new and refined modern business processes to be implemented as part of the ERP solution.

Risk Management

68 Implementing ERP solutions is a complex and demanding process and requires the management of a number of risks to project success. However, we were unable to locate a comprehensive risk register for the PMIS project. In response to our enquiries we were informed that three main strategic risks to the project had been monitored and were discussed at Steering Committee meetings.

69 For a project of the scale and complexity of PMIS we would expect a comprehensive risk register to be maintained from the outset so that all threats to the success of the project could be identified and mitigated to the fullest extent possible. The absence of a comprehensive approach to risk management weakens management's ability to identify and address risks as they arise thus increasing the likelihood of risks being overlooked and imposing additional unforeseen costs and delays on the project. Failure to adequately manage project risks ultimately jeopardises the success of the project itself.

Recommendation 11: We recommend that a comprehensive risk management approach is introduced for the ERP project. A register of all risks affecting the project should be compiled and submitted to the Project Steering committee on a regular basis.

Conclusions

70 The PMIS project has made good progress in some important areas such as establishing a project governance framework, documenting the existing business processes in considerable detail and in identifying potential software suppliers and integration partners to help PAHO install an ERP solution.

71 However, some fundamental elements of best practice were either missing or under-developed from the project at the time of our review. Failure to address these weaknesses will, in our view, place the success of the project at risk. In particular, the following elements need to be fully developed as a matter of urgency:

- The Project Charter should be updated and completed;
- The project budget should be re-examined in more detail and the total costs of implementing and maintaining an ERP solution for PAHO should be calculated. The original budget of \$20.3 million should be subject to robust challenge and validation to confirm that it remains adequate;
- Detailed project plans should be prepared to show the full range of project activities to be completed together with their estimated resource requirements. Project milestones and key target dates should be defined to enable the “critical path” for the project to be identified; and
- Change management and communication plans should be prepared together with a comprehensive risk register for the project.


Follow up of prior year recommendations

72 In our report for 2010, we made a number of recommendations on how to improve upon the implementation of IPSAS and how to embed the culture required to consistently report effectively in this way, including: the need to put in place new financial accounting systems; communication and effective training of Country Offices; and more central ownership for processes such as the identification of accruals. 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.

73 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 identification of accruals, and only minor errors have been noted in-year as a result. However further progress can be made, as the need to hire external assistance in the accruals process is an expensive one that cannot be sustained in the longer term and the accruals concept is one that requires further embedding within some Country Offices. As a result a number of these responses have only been partially implemented to date as they are currently in progress.

Acknowledgement

74 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 and throughout our tenure as external auditor.


Anyas C E Morse
Comptroller and Auditor General, United Kingdom
External Auditor
13th April 2012

Annex A - Summary of Audit Recommendations

Recommendation 1: We recommend that PAHO continues to impress upon key staff across the Organization the importance of understanding the accruals concept and obtain complete and relevant evidence to support the level of accrued expenditure reported at the year end. PAHO should also consider further strengthening their internal review procedures in view of the errors which continue to be made.

Recommendation 2: We recommend that PAHO puts measures in place to ensure that staff throughout the Organization comply with laid down procurement procedures. This will ensure that PAHO makes the most effective use of its resources and receives value for money from its purchases. Particular emphasis should be placed on ensuring Letters of Agreement are used appropriately and on the prevention of single source tendering. Where single source procurement is used the reasons for such action should be clearly documented.

Recommendation 3: PAHO's investment in developing a risk management framework is welcomed and we recommend that progress be reviewed against the project target dates to ensure that it is embedded within procedures and the culture of PAHO as soon as possible.

Recommendation 4: We further recommend that PAHO review the resources devoted to the implementation of the system to ensure that they are adequate to cope with the future roll out, and that the successful implementation and maintenance of the new system is not over-reliant on the efforts of one key member of staff.

Recommendation 5: While such expertise can be bought in for specific assignments, we recommend that IES review its staffing profile and consider whether it requires further specialist information systems audit resources. Such skills may be of particular added value in future as PAHO begin the implementation of a new ERP system.

Recommendation 6: We recommend that IES develops performance indicators to measure how well they perform against their annual audit plans and over time. Examples of such measures include: the proportion of audit recommendations accepted by management; the number of recommendations implemented within a given timescale; financial savings generated as a result of audit recommendations; the costs of reports delivered compared to planned costs; and the number of reports delivered compared to those planned. IES need to develop measures which are specific to their and PAHO's circumstances.

Recommendation 7: We recommend that management take action to improve the implementation rate of IES recommendations as a matter of priority so that IES can "add-value" in the timeliest manner.

Recommendation 8: We recommend that a fully articulated and detailed business case in support of the ERP project is formulated as soon as possible. The business case should state clearly the business need for the project together with the costs and benefits it is expected to generate.

Recommendation 9: We consider that significant uncertainty is attached to the current project budget and recommend that it be re-examined in more detail. The full estimated costs of implementing the ERP solution in PAHO should be calculated including the costs of elements currently excluded from the approved project budget. In future, project budget and forecasts should be regularly updated and reported to management on a periodic, preferably monthly, basis.

Recommendation 10: We recommend that comprehensive change management and communication plans are drafted as a matter of priority. Similarly, work needs to be completed on the definition of new and refined modern business processes to be implemented as part of the ERP solution.

Recommendation 11: We recommend that a comprehensive risk management approach is introduced for the ERP project. A register of all risks affecting the project should be compiled and submitted to the Project Steering committee on a regular basis.

Annex B - Implementation of Prior Year Recommendations

We reviewed management's implementation of recommendations made in our prior year long form report. We have summarised the response and provided our evaluation, based on the audit work we have undertaken in respect of internal controls.

Follow up of Prior Year Recommendations

Recommendation	Management Response	External Auditor's Comment
<p>Recommendation 1:</p> <p>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.</p>	<p>PAHO uses information from the actuarial surveys to set funding levels for the TAREP and ASHI Funds, which are included in individual post costs on a monthly basis. The rates of contribution to these funds are reviewed periodically and adjusted as required in order to meet funding objectives. Furthermore, in 2012 the Secretariat has submitted a proposal to the Governing Bodies for the use of a portion of the IPSAS surplus to fund the ASHI liability. The Secretariat is also considering the use of the actuaries to recommend long term funding options for ASHI.</p>	<p>PAHO have acknowledged the need to allocate funds to meet these liabilities and have some funding already set aside. The increased rate of contributions and the suggested use of some of the current surplus (\$10m) funds will further address our recommendation. However the use of surplus funds will not be put to Directing Council for approval until September 2012 and there is still no long term plan in place to fund the liabilities for employee benefits. While significant progress has been made, this recommendation cannot yet be considered fully cleared.</p> <p>Partially Implemented</p>
<p>Recommendation 2:</p> <p>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.</p>	<p>As part of the implementation of the PAHO Enterprise Risk Management Process, each Area will complete a risk identification and analysis process. The Area of Procurement and Supply Management (PRO) participated in the PAHO Revolving Fund risk management analysis in October 2011. This analysis covered commodities that represent more than 80% of the total PAHO procurement portfolio.</p>	<p>The results of this analysis were not available at the time of writing and so we cannot comment in full, furthermore it is unclear if this addresses the risk of single source procurement. As a result this recommendation cannot be considered cleared at the time of writing this report.</p> <p>Partially Implemented</p>

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.

Weekly closure meetings with key Financial Resources Management (FRM) staff were held in order to establish 2011 closure requirements, and review the procedures used in 2010. From these meetings, responsible parties within FRM were identified to enhance FRM's policies and procedures in accordance with the weaknesses identified and other observations. Training of Country Offices & HQ personnel was provided to strengthen knowledge in the application of IPSAS. The FRM Financial Systems continue to be enhanced to meet recording and reporting requirements. However, an ERP is essential to facilitate the complex requirements of IPSAS and to mitigate the risks inherent in the legacy systems and workarounds developed to capture and integrate information.

We note the actions taken to date but consider this to be a continuing process. We note improvements in 2011 as a result of extra training being provided to Country Offices etc. However there remains room for improvement in some areas as noted in this audit report (e.g. embedding of the accruals concept).

Ongoing

Recommendation 4:

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

The PMIS modernization is an ongoing project to implement an ERP system, which was approved by the Directing Council in 2010. This is a long duration project that is not expected to be fully complete until the next biennium. In 2011, a Request for Proposal was issued for both the ERP software and a Systems Integrator. Final selection should be completed in 2012.

While we agree with these comments it is clear there is some way to go before the ERP will be fully implemented. We have commented in the main body of the report on the current status of the ERP project.

Ongoing

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.

FRM emphasized the monitoring of obligations on a monthly basis. For Country Offices FRM developed a plan to effectively monitor obligations, supporting documentation, and implementation of activities. In HQ hands-on training on expense recognition began in the third quarter of 2011 and extended throughout closure. This training was mandatory for all technical units. This included working one-on-one with administrative and technical personnel on the Expense Recognition Dashboard in preparation for the final closure exercise.

We have noted an improvement on the prior year as a result of the actions taken but have also come across some obligations that are no longer required but were not cancelled leading to invalid accruals at year end. Therefore further work is still required to embed the training and effectiveness of the procedures implemented by PAHO in 2011.

Partially Implemented

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.

The FRM Country Accounting Services Team (FRM/AR/C) reviewed existing obligations balances on a monthly basis and followed up with Country Offices for actions. A plan of action for obligation monitoring was provided to large country offices. A SharePoint site was made available for allottees to provide supporting documentation for their accrued expenses, as part of the 2011 financial closure exercise. These documents were spot checked by the Accounting team prior to the recognition of accrued expenses in the Organization's accounting system.

For the 2012 closure, FRM/AR/C will expand its review and request a re-certification of the expense recognition data as of 10 January.

We recognise the effort that went into the improved procedures and review of accruals over \$30,000 centrally and this helped in reducing the error rate in the account. As noted above, however, we consider that further work remains to be done to reduce the level of error to acceptable proportions.

Partially Implemented

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.

As a result of decisions made with respect to the funding level designated for TAREP and ASHI, which are based on the results of the actuarial valuations conducted in response to IPSAS 25 requirements, post costs have increased reflecting the monthly charges against individual allotments that take place to fund the respective liabilities. The higher post costs are reported to Member States through the Biennial Workplan.

While the greater understanding of the liability is welcomed, it has not yet resulted in a revised HR policy that we are aware of.

Partially Implemented

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.

The Framework has been established as recommended and communications were issued to the Organization. FRM worked with the Areas of Knowledge Management and Communication (KMC), Information Technology Services (ITS) and Health Systems based on Primary Health Care (HSS) and developed a standardized reporting process documenting programmed budgets and costs for intangible assets. A governance and oversight committee has been established by KMC. Financial Systems (FRM/FS/S) is a member of this committee.

While the system has been implemented the processes are yet to be fully embedded which resulted in some omissions of intangible assets at the year-end. More communication across the Organization is required to ensure this system functions in the most effective manner.

Partially Implemented

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.

The corporate response mechanism document was finalized and presented to Executive Management. The main principles of the new response mechanism were approved. The document is expected to evolve with the humanitarian reforms and lessons learned from previous disasters.

The document was issued on 9 February 2012 and so was not in place during the 2011 financial year. However it does incorporate major lessons learnt and addresses the key concerns. We note that this document will continue to evolve and draw on lessons from elsewhere. We are content that the document addresses our core concerns and consider that staff would benefit from formal training to accompany this document as it is provided to PAHO employees.

Implemented**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.

The FRM Country Accounting Services (FRM/AR/C) visited PWR-Brazil in September and October 2011. The PWR-Brazil Office structure continues to be de-centralized. Some progress was made in 2011 to strengthen the coordination of operations between Administration and the Technical Units. FRM/AR/C will continue to closely monitor financial operations at PWR-Brazil through spot checks and monthly conference calls with the Administrator and other key staff members in the administration team.

The additional support provided has been crucial to the improvement in the Brazil Country Office in 2011, including the review of accruals performed by a consultant on behalf of PAHO. However the errors found during the 2011 audit, although much reduced compared to 2012, demonstrates that further support is still required going forward, particularly given staff turnover within the Brazil office.

Partially Implemented

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.

The first meeting of the Audit Committee for 2012 will take place in Washington from 10-11 April. The Committee will have the opportunity to review the Financial Report of the Director and receive a briefing from the External Auditor.

This will act as an effective control in ensuring that the Audit Committee meets the needs of PAHO, therefore it should be a regular agenda item built into meetings as often as is felt necessary (with respect the Terms of Reference).

Implemented

Recommendation 12:

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

PAHO's approach to risk management is an integral and systematic process not represented by a static risk register but by a process that is continuously identifying, mitigating, monitoring and communicating top risk events to the Organization. This type of process requires a risk management framework, risk governance, a risk assessment methodology and training before comprehensive risk assessments can be performed which is what is required before creating a factual and accurate risk register.

While we agree with these comments and welcome the progress made, it is clear there is some way to go before these processes are fully embedded. We comment further on this subject in the main body of our report.

Partially Implemented

In April 2011, AM presented the conceptual framework to the EXM based upon ISO31000 which was approved. Two risk assessments were conducted in the Areas of Procurement and Supply Management and the Revolving Fund for Vaccine Procurement to test the methodology designed to ensure it was appropriate for the Organization. As a result of these exercises, AM has approved the methodology to be employed and has scheduled the conduction of risk assessments for the Areas of Financial Resources Management, Procurement and Supply Management, Information Technology Services, General Services Operations and Human Resources Management which are scheduled to be completed in the spring 2012. As a result of this effort an initial risk register will be published during the 2nd quarter of 2012.