



National Audit Office

2006-2007

## External Auditor's Report

The National Audit Office (NAO), headed by the Comptroller and Auditor General of the United Kingdom, provides an external audit service to the Institute of Nutrition of Central America and Panama (INCAP). The External Auditor has been appointed by the Directing Council of INCAP in accordance with Regulation XIV of the Financial Regulations. In addition to certifying the accounts of INCAP, he has authority under the mandate to report to the Directing Council on the economy, efficiency and effectiveness with which the Institute has used its resources.

The aim of the audit is to provide independent assurance to the Directing Council; to add value to the Institute's financial management and governance; and to support the objectives of the Institute's work.

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## Audit of the Financial Statements of the Institute of Nutrition of Central America and Panama (INCAP)

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## EXECUTIVE SUMMARY

- *An unqualified audit opinion on INCAP's financial statements*
- *Commentary on the financial results and internal controls for 2006-2007*
- *Identification of the risks arising from the potential separation of INCAP and PAHO*
- *Review of extra-budgetary trust fund projects and related programme support costs*
- *Follow up to previous audit recommendations*

## OVERALL RESULTS OF THE AUDIT

1. We have audited the financial statements of the Institute of Nutrition of Central America and Panama (INCAP) in accordance with the financial regulations and in conformity with International Standards on Auditing. The audit examination revealed no weaknesses or errors which we considered to be material to the accuracy, completeness and the validity of the Institute's financial statements. In my opinion, these financial statements present fairly, in all material respects, the financial position as at 31 December 2007 and the results of operations and cash flows for the period then ended, in accordance with United Nations System Accounting Standards and INCAP's stated accounting policies.
2. The main observations and recommendations from our audit are summarised below, with a more detailed commentary in the section on Detailed Findings. The scope and approach of the audit, which were communicated to management in a detailed audit strategy, is summarised at **Annex A**.

### On the overall financial results of INCAP

3. During the financial period the Institute received \$1.42 million regular budget income, and incurred related expenditure of \$1.46 million. After providing for delays in the collection of assessed contributions, and adjusting for contributions received in relation to prior years, the financial statements record a net excess of income over expenditure of \$3,406. This amount

has been transferred to the Endowment Fund in line with INCAP regulations.

4. Regular budget funding included \$857,400 quota income from assessed contributions. This increased by \$50,000 from the previous biennium, since 2006-2007 reflected the first full biennium of membership for the Dominican Republic. We commend the Institute on maintaining a high collection rate for quota income: the proportion of quota income collected has continued to improve over the last decade, reaching 94 per cent in 2006-2007.
5. The value of trust fund income to INCAP increased by 183 percent from \$1.82 million in 2004-2005 to \$5.2 million in 2006-2007. This is largely attributable to the Presanca project which alone generated \$1.43 million (28 percent) of all trust fund income. We have commented on this project in more detail further below.

#### **Internal financial controls**

6. As part of our audit, we routinely test the effectiveness of internal financial controls. Our review of the relevant systems and procedures for audit purposes found these to be working effectively and that the Institute had maintained an effective level of internal financial control during the biennium.

#### **Financial accounting systems**

7. From our audit of the records produced by the financial accounting system and other supporting evidence, we concluded that in all material respects proper books of account had been maintained and that these were sufficient to support the biennial financial statements and audit opinion.

#### **Write offs, other losses and frauds**

8. INCAP reported no write offs during 2006-2007 and none were noted during our audit. During the biennium INCAP suffered three incidences of thefts of Institute property. Successful insurance claims were made in two cases but a stolen vehicle had not been insured for theft as PAHO and INCAP have a policy of ensuring for third party damage only. The estimated value of the vehicle was \$5,141.

## On INCAP's separation from PAHO

9. During the 2008-2009 biennium PAHO and INCAP plan to separate their administrative and governance structures. The transition is designed to give INCAP greater operational independence, which will also bring responsibility for its own system of internal control.
10. This transition brings with it numerous risks for both INCAP and PAHO. Issues which are particularly significant from an audit perspective include the future financial security of INCAP, the control of INCAP's staff provident fund, the appointment of a new Director and the future operating and governance arrangements for the Institute. These issues will have a significant impact on the control environment of INCAP and we have recommended that these aspects need to be adequately resolved before the transition is formalised.

## On trust fund projects

11. As well as performing standard testing on trust fund income and expenditure, the audit team spent some time reviewing in more detail a sample of three trust fund projects from the 2006-2007 biennium. We confirmed that expenditure had been in line with the expected profiles of the projects and that evidence of delivery was available.
12. During this review we noted that project management arrangements and reports did not incorporate financial targets or other key performance indicators to measure the relative success of each project. For example, in each of the projects designed to help communities to establish food or agricultural micro enterprises, INCAP in consultation with the donors could set targets for the number of such enterprises established, the amount of revenue generated through the sale of produce from such enterprises and performance measures on improved nutrition in each community. We have recommended that in consultation with trust fund donors INCAP should consider developing more objective key performance indicators to measure the achievement of projects, which can be used in addition to the subjective measures relied on at present.

13. We observed that only 10 of the 41 trust funds (or 26 percent) against which INCAP expenditure had been charged included an allowance for project support costs. This compares to a larger proportion of 13 of 28 trust funds (46 percent) in 2004-2005. Consequently income to the Project Support Costs Fund decreased by \$52,000 or 47 percent and INCAP regular budget income has effectively subsidised some projects by covering the majority of the Institute's administrative costs. There is a risk that if regular budget income were to fall, INCAP would struggle to fully cover its administrative overheads. We have recommend that INCAP seek to include project support costs in project agreements where possible; and ensure that the overheads of the organisation are fully recovered, unless explicit decisions are taken to subsidise the activities from the regular budget.
14. Through this review process, we noted that many of INCAP's projects rely on partnerships with PAHO country offices. We have recommended that INCAP and PAHO review how this coordination will be retained or replaced when INCAP becomes independent from PAHO.

### **Follow up to previous audit recommendations**

15. In our 2004-2005 report we recommended that that INCAP work closely with PAHO to prepare a detailed strategy for a move to International Public Sector Accounting Standards, IPSAS. This is a gradual change process. In this present report we have provided details of some key areas which will be affected by the transfer to IPSAS; and have recommended that INCAP formulate a detailed plan for achieving compliance with the standards, and act promptly to ensure that they have the mechanisms for collecting and reporting the required accounting information.
16. In 2004-2005, we reported that INCAP had been dependent on a small number of key donors for trust fund income for the biennia 2002-2003 and 2004-2005. These donors accounted for 77 per cent of trust fund income in 2004-2005. For 2006-2007, INCAP increased the number of donors from 12 to 18. However, while the number of donors has increased significantly, there is a greater concentration in donor income from the Central America Integration System (SICA), which accounted for 78 per cent of all voluntary contributions in the biennium. We have recommended that INCAP continue to regularly review the profile of voluntary contributions donors and actively manage the risk of reliance on key donors.

## DETAILED FINDINGS

### FINANCIAL RESULTS - THE INCAP REGULAR BUDGET

17. Statement XI reports that during the financial period the Institute received \$1.42 million in regular budget income and incurred related expenditure of \$1.46 million. After providing for delays in the collection of assessed contributions, and adjusting for contributions received in relation to prior years, the financial statements record a net excess of income over expenditure of \$3,406. This amount has been transferred to the Endowment Fund in line with INCAP regulations.

#### Collection of quota income

18. INCAP's total income from assessed contributions (quota income) rose from \$807,400 in 2004-2005 to \$857,400 for 2006-2007. Quota contributions from all INCAP member states remained the same as the previous biennium. The increase of \$50,000 in total contributions was due to the Dominican Republic's first full biennium of membership of the Institute.

19. The proportion of assessed quota income collected has continued to improve over the last decade, reaching 94 per cent in 2006-2007 (Figure 1). The Institute's continued success in collecting arrears of contributions means that outstanding amounts (\$59,496) once again relate only to the most recently completed biennium. The balance due to INCAP at biennium-end stood at its lowest level for more than fifteen years.

**Figure 1 – Collection Rates For INCAP Quota Contributions (Including arrears)**

Biennium	Net Assessments*	Amount Collected	Outstanding Collection	Rate
	\$	\$	\$	%
2006-2007	957,971	898,475	59,496	94
2004-2005	1,000,216	899,645	100,571	90
2002-2003	1,097,387	904,571	192,816	82
2000-2001	1,198,379	858,392	339,987	72
1998-1999	1,221,881	780,902	440,979	64
1996-1997	1,172,074	707,594	464,480	60

\* Quota amounts due for the current biennium plus any outstanding amounts relating to previous biennia.

Source: INCAP Financial Statements 1996-1997 to 2006-2007

### Trust fund income

20. The value of trust fund income to INCAP increased by 188 per cent, from \$1.8 million in 2004-2005 to \$5.2 million in 2006-2007. The proportion of INCAP's income represented by trust funds has also increased from 29 per cent in 2004-2005 to 54 per cent in 2006-2007.

21. The increase in trust fund income is largely attributable to the Presanca project which alone generated \$1.43 million. This represents 28 percent of all trust fund income and 15 per cent of INCAP's total income.

### Miscellaneous income

22. Regular Budget revenue-producing income from the provision of specific services in technical co-operation to Non-Governmental Organisations (NGOs) and private institutions once again decreased, from \$312,135 in 2004-2005 to \$306,756 in 2006-2007. This small decrease of \$5,379 is the result of the cessation of income from cookie sales being offset by increased income from Incaparina sales. New Incaparina products for the elderly, pregnant women and sportspeople were introduced in the biennium.

23. Other and miscellaneous income continued to increase, from \$124,841 in 2004-2005 to \$171,728 in 2006-2007. This resulted in part from a full two years' worth of rent from the Interamerican Institution for Agriculture Cooperation (IICA) which began renting office space from INCAP in June 2005. In addition, miscellaneous income for 2006-2007 included \$32,226 from the sale of two INCAP vehicles.

24. Income generated by the Institute within the Special Fund for INCAP Services has risen slightly from \$188,845 in 2004-05 to \$190,249, resulting from small increases in the recharge rates for photocopying and transport services.

### Internal financial controls and accounting systems

25. We routinely test the systems of internal financial control in operation at INCAP. Our work involved:

- Ensuring that appropriate internal controls are in place for processing income and expenditure; and

- Tracing transactions through the systems of internal control to ensure that controls worked effectively during the financial period;
26. Our review of these systems and procedures for audit purposes provided sufficient evidence to conclude that the Institute had maintained an effective level of internal financial control during this biennium. We found no examples where established key controls had not been followed but we identified cost-effective improvements that could be made to further enhance the level of control in operation and these will be reported separately in our routine report to management (management letter). Areas where potential improvements have been identified include: fraud reporting; the monitoring of trust fund income receivable; independence of bank signatories; fixed asset verification; and authorisation of salary advances.
27. As a part of effective governance arrangements, INCAP would benefit from regular internal oversight to help maintain and strengthen the system of internal controls. Under the existing arrangements, PAHO's department of Internal Oversight Services (IOS) is responsible for providing this service but IOS has not undertaken any work at INCAP since 1998.
28. In addition to the review and testing of internal controls, we undertake tests of detail on transactions processed throughout the biennium; and we fully review and reconcile the general ledger to the financial statements to confirm that all transactions have been properly recorded and reported. From our audit of the books of accounts and other supporting evidence, we concluded that in all material respects proper records of income, expenditure, assets and liabilities had been maintained and that these had been accurately reported in the biennial financial statements and were sufficient and reliable to support an unqualified audit opinion.

#### **Amounts written off, other losses and fraud**

29. INCAP did not report any amounts written off during 2006-2007 and none were noted during our audit. However the financial statements report three thefts as follows:
- Toyota 1993 4x4 Hilux Vehicle – stolen.
  - Toshiba laptop – stolen from a staff member's vehicle while on an INCAP mission.
  - Three signed cheques – stolen from a messenger while in transit to the bank to be cashed.
30. Only the loss of the Toyota resulted in a net loss for INCAP, as successful insurance claims were made for both the laptop computer and the cheques. INCAP only insures vehicles for third party damage. The Institute confirmed that there had been no cases of fraud or presumed fraud reported during 2006-2007.



## INCAP'S SEPARATION FROM PAHO

31. During the 2008-2009 biennium, INCAP and PAHO plan to separate their administrative and governance structures. At present PAHO provides administrative support to INCAP and as such the Institute falls within PAHO's system of control and governance arrangements: PAHO provides nearly half of INCAP's funding; the Director of INCAP is appointed by the Director of PAHO; PAHO is represented on INCAP's Directing Council; and INCAP operates to rules and regulations laid down by PAHO.
32. The transition process will give INCAP greater autonomy and responsibility for its own system of internal control. It is the aspiration of the organisation that by becoming an independent entity, INCAP will become more responsive and better able to meet the nutritional and food technology needs of the Central American people, once it has greater control over its operating environment.
33. Following the separation, PAHO will continue to be represented on the INCAP Directing Council and will continue to provide funding to the Institute, but PAHO's exact relationship with INCAP following the transition is yet to be clearly defined.
34. INCAP is submitting a plan to the INCAP Directing Council in September 2008 to gain approval for revised, independent administrative arrangements, and financial rules and regulations. In October 2008, the PAHO Directing Council will then consider a decision on this separation. While these decisions will mark a formal separation between the two entities, the process is likely to take a substantial period of time to complete if approved.
35. This transition brings with it numerous risks for both INCAP and PAHO. We have identified a number of areas where we see potentially significant risks for the organisations and these are identified in Figure 2.

**Figure 2 - Potential Risks and Issues of Separation between INCAP and PAHO**

Risk	Areas to be addressed by INCAP
<p><b>Financial solvency</b></p> <p>INCAP receives a significant proportion of their total income from PAHO: in 2006-2007 INCAP received \$2,294k from PAHO compared to the \$857K received in quota contributions from member states.</p> <p>The future security of the level of PAHO funding is critical to INCAP as it is this regular budget funding supports the administrative and overhead costs of the organization.</p>	<p>The ability of INCAP to meet its core operating costs may be in question without long term PAHO financial support.</p>
<p><b>Investment Management</b></p> <p>PAHO currently hold funds, including the staff provident fund, on behalf of INCAP and invests these funds to generate optimum interest.</p> <p>PAHO is not a financial institution and the continuation of this service beyond the transition may not be appropriate.</p>	<p>INCAP will need to establish treasury management arrangements to benefit from optimum interest income placing an additional administrative burden on the organization which may not potentially have the expertise to resource this function.</p>
<p><b>Professional appointments</b></p> <p>The Director of INCAP is a PAHO employee and as such the Director's salary is met by PAHO.</p> <p>INCAP currently have an interim Director in place and plan to employ a new Director directly following the transition</p>	<p>The Director's salary is a significant cost to PAHO which may not be appropriate for PAHO to meet following separation between the organizations.</p> <p>If INCAP cannot afford to pay a competitive salary to prospective candidates, they may not be able to attract a suitable candidate for this mission critical post.</p>
<p><b>Financial rules, regulations and operating policies</b></p> <p>PAHO's internal control structure, pay scales and operating policies are observed within INCAP. While INCAP has some existing internal procedures, under current arrangements PAHO policies are commonly used.</p>	<p>The need to establish INCAP's own rules, regulations, policies and practices may lead to a weakening of the internal control environment, particularly during the period of transition and staff training.</p>

Risk	Areas to be addressed by INCAP
<p><b>Good Governance</b></p> <p>PAHO provides governance and high level control functions to INCAP – notably with regard to fraud monitoring, IT security, external audit and internal oversight.</p>	<p>INCAP will need to establish its own governance arrangements to ensure appropriate internal controls, external and internal oversight. This again may place additional burden on the organization where previously it benefited from the service provided by PAHO.</p>
<p><b>Legal Services</b></p> <p>PAHO provides legal services to INCAP – notably the review of all Trust Fund agreements and Letters of Agreement.</p>	<p>Without alternative arrangements for legal services support there is a risk that INCAP may not be able to easily continue the arrangements for accepting voluntary contributions and establishing trust funds. In addition the critical control provided by PAHO legal services on Letters of Agreement may be dissipated.</p>
<p><b>PAHO Training and Other Services</b></p> <p>Staff training is provided by PAHO for free, including ethics training and technical training. In the future charges may be made for these services.</p>	<p>INCAP may not be able to maintain the training and development needs of their staff without the ongoing support of PAHO and without alternative arrangements for staff training in place. This may have a negative impact on INCAP's delivery objectives.</p>
<p><b>PWR support to INCAP projects</b></p> <p>INCAP projects often benefit from support and the coordination services of the Central American PWR offices.</p> <p>The relationship between INCAP and PWR offices will be different following the transition because they will not be part of the same organisation</p>	<p>If the existing arrangements between INCAP and PWR offices are not maintained, there is a risk that future projects managed by INCAP with the support of PWR offices may not be sustainable with a detrimental effect on continued funding from project donors.</p>

***Recommendation 1: We recommend that PAHO and INCAP work together to ensure that an action plan is developed for INCAP's transition to independent status which responds appropriately to the key risks presented by the separation.***

## **TRUST FUND PROJECTS**

36. Trust fund income and expenditure increased significantly in 2006-2007. We routinely carry out an audit examination and detailed testing on a sample of individual items of trust fund income and expenditure. In addition to this work, we performed a broader-scoped review of three trust fund projects which accounted for \$1.51 million of expenditure. This represented 45 percent of total INCAP project expenditure in the biennium. The three projects selected were:

- The Central American programme to support small enterprises headed by women, producers of food, with emphasis in nutritionally enriched foods (Project Reference: NUT 463);
- Support for agro-industrial micro-enterprises of Nicaragua and Costa Rica (NUT 469); and
- Technical assistance of INCAP A Presanca (NUT 473).

37. We interviewed project managers and reviewed the project agreement and project reports produced for donors on each of these projects. We also reviewed the financial information in relation to these projects and assessed the degree to which project objectives were reflected in this information. Our findings were as follows.

***Project 1: Central American programme to support small enterprises headed by women, producers of food, with emphasis in nutritionally enriched foods***

38. The main objectives of this project were to provide training and education for women and food producers to produce and distribute food in poor communities. The project covered all the Central American countries and was focussed on poor border communities and those where basic foods are not easily accessible. INCAP provided training and food technology for such communities to set up and sustain the production of food stuffs such as cereals, legumes and bakery products. The funding for the project has been used by INCAP primarily to provide training and equipment.

39. Total expenditure on this project amounted to some \$188,265 in 2006-2007, with a brought forward balance of \$183,674 at the start of the biennium and additional funding of a further \$4,591 received during the period. Funding for this project was provided by the Central American Integration System (SICA) but was originally received from the Taiwanese government. The project is now complete and total expenditure at the end of this biennium matched the funding received since 2005.
40. Of the \$188,265 available for this project, some 84 percent of funding was used on the following areas:
- Support and training provided by locally employed staff - \$91,344 or 49 percent of total funding;
  - Training provided by INCAP professional staff - \$29,544 or 16 percent of total funding;
  - Operational overheads - \$21,135 or 11.2 percent of total funding; and
  - Courses, workshops and seminars - \$15,200 or 8 percent of total funding.
41. The project manager considered this project to have been successful and that in particular communities targeted in El Salvador, border of Guatemala, Honduras and El Salvador along with the border of Costa Rica and Nicaragua have benefited from this project. We have seen video and documentary evidence evaluating the project, although the use of quantitative performance indicators and also other qualitative measures would further improve the quality of project assessment and evaluation.

***Project 2: Project to Support for agro-industrial micro-enterprises of Nicaragua and Costa Rica***

42. The main objectives of this project were to provide training, education and equipment for people in rural municipalities in the Nicaraguan and Costa Rican border areas, to help them develop micro enterprises in producing food and other agricultural products for sale in their communities. Again the funding for this project has been primarily used by INCAP to provide training and equipment.

43. Total funding for this project at the time of audit was \$247,734 which had been received from the donor in 2006-2007. Some \$238,360 had been spent on project activities with a balance of \$11,571 carried forward to the next biennium. Funding for this project was provided by the Belgian government. Of \$238,860 spent on this project, 87 percent had been used on the following areas:

- Courses, workshops and seminars - \$98,653 or 41 percent of total funding to date;
- Contractual services - \$41,286 or 17 percent;
- Support and training provided by locally employed staff - \$34,645 or 15 percent; and
- Training provided by INCAP professional staff - \$32,696 or 14 percent of total funding to date.

44. The evidence seen of project implementation was consistent with our analysis of project expenditure, in that the funding had been used primarily to recruit local professionals to provide training and support directly in the local communities. A significant part of the funding had been used for obtaining and supplying equipment to help set up enterprises.

### ***Project 3: Technical assistance of INCAP Presanca***

45. The main objectives of the project are to improve food and nutritional security. INCAP's role is that of providing technical support and monitoring projects delivered by local Non-Governmental Organisations within 62 municipalities in four countries.

46. Total funding for this project was \$1,425,284, all of which had been received from the donor in 2006-2007. Against this, some \$1,081,521 had been spent on project activities with a balance of \$343,763 being carried forward to the next biennium. Funding for this project was provided by SICA. Of the \$1,081,521 spent on this project, 66 percent of funding had been used in the following areas:

- Contractual services - \$404,124 or 37 percent;
- Locally employed staff - \$178,602 or 17 percent of total expenditure to date; and
- Scholarships - \$128,630 or 12 percent of total expenditure to date.

47. The scholarships expenditure reflects an innovative aspect of this project: rather than employ consultants to coordinate Presanca activities at the local level, INCAP is investing some funds in offering a masters qualification to locally-based professionals. These individuals can gain the skills and experience needed to coordinate this and future projects, while gaining a qualification and remaining available to provide ongoing support to such projects. As with other projects, this project would also benefit from a more structured evaluation of the project results using key performance indicators.

### **Audit findings relating to all trust fund projects**

48. We reviewed project files for the three projects, which showed sufficient evidence that the appointed project managers had monitored the projects throughout their life cycle and that INCAP had reported the outcome of the projects to the project donors and PAHO Headquarters. Evidence of coordination with ministries of health was also available.

49. A variety of evidence on the delivery of the projects was available to us for audit purposes. For example, for project NUT 469 we reviewed video evidence demonstrating the implementation in the communities and municipalities and the impact of the project on the lives of the people in these communities. INCAP have also produced training materials, such as guide books on how to run small enterprises, using very simple language and charts to communicate fundamental messages to people in these communities who are poorly educated. In addition we reviewed applications for the INCAP masters course, files of successful candidates and outlines of the courses studied under NUT 473.

50. As a part of our audit testing of trust funds more generally, we sample-tested transactions in respect of these three projects, and confirmed that the receipts and expenditure had been fully and properly accounted for, and that transactions had been properly authorised. In addition, we confirmed that expenditure had been properly allocated to expenditure categories in line with the original project plans, and been correctly accounted for subsequently. We confirmed that the brought forward balance at the start of the biennium, income received and expenditure during the biennium had been properly reported in INCAP's financial statements, which included detailed disclosure of trust funds in Schedule 10.

51. In order to continue attracting voluntary contributions, it is important that INCAP can demonstrate sound internal control and financial management of the projects, as donors expect detailed reports and feedback on progress as well as assurance on how the funding has been used. We confirmed from our work on the audit sample of projects that income and expenditure had been processed through the same rigorous controls as the rest of INCAP's transactions. Combined with the project management and reporting aspects, this provides sound internal control over donor funding. INCAP project managers made available primary evidence of how funding had been used, as well as reports to donors and others. We concluded that there were sound controls, procedures and accountability arrangements over the Institute's use and management of trust funds.
52. However, we noted that project files and reports did not incorporate financial targets or other key performance indicators to measure the relative success of each project. For example, in each of the projects designed to help communities establish food or agricultural micro enterprises, INCAP could set targets in consultation with donors for the number of such enterprises established; the amount of revenue generated through the sale of produce; and a measure for improved nutrition in each community.

***Recommendation 2: We recommend that in consultation with trust fund donors, INCAP consider developing more objective key performance indicators to measure the achievement of projects, for application in addition to the subjective measures used at present.***

53. None of the three projects we reviewed in detail provided for a defined charge for project support costs. In discussion, INCAP staff informed us that this reflected an increasing trend for donors to refuse to fund a pre-set administrative overhead but rather to pay for specific administrative work within the project plan. Indeed a review of the profile of all projects active in 2006-2007 revealed that only 10 (26 per cent) of the 41 trust funds against which INCAP expenditure was charged had included an allowance for project support costs. This compared to 13 (46 per cent) of 28 trust funds active in 2004-2005. Consequently income to the Project Support Costs Fund decreased by \$52,000 (47 per cent) and INCAP regular budget income has effectively subsidised some projects by covering the majority of the Institute's administrative costs. There is therefore a risk that if regular budget income were to fall, INCAP might struggle to cover its administrative overheads.



***Recommendation 3: We recommend that INCAP seek to include project support costs in project agreements where possible, and ensure that the overheads of the organisation are fully recovered, unless explicit decisions are taken to subsidise the activities concerned from the regular budget.***

54. Our review of project contracts and related documentation also showed that for two of the projects examined, no formal authorisation of the project by PAHO had been obtained. This is an issue we raised in our interim report to management. It was explained to us that in one case, PAHO had not signed the contract because it does not contract with governments who are outside the United Nations. In the case of the Belgium funded project, we were informed that PAHO were aware of the project but had not formally signed an approval. INCAP management accept that while existing governance arrangements continue, they will only sign agreements with PAHO's explicit authority.
55. From our discussions with project managers and review of project documentation, we established that for many projects INCAP works in partnership with the PAHO Country Offices in the Central American countries involved. Funding is co-ordinated by the PWR Offices for use on the projects in local municipalities. If INCAP separates from PAHO, the nature of the relationship between PAHO and INCAP will change and the existing arrangements with PWR Offices to co-ordinate projects at a local level will no longer be appropriate. Notwithstanding INCAP's strategy to develop new relationships and partnerships in this region, both PAHO and INCAP need to consider how the project support enjoyed by INCAP through PWR Offices can be replaced or replicated following the transition.

***Recommendation 4: We recommend that PAHO and INCAP review the existing arrangements in place for PWR Offices to provide support to INCAP Trust Fund projects, in order to assess how these arrangements should be continued following the transition when INCAP becomes independent from PAHO. In doing so, both bodies will need to consider the impact on continued donor funding if these arrangements are no longer sustainable; and review the potential impact on the communities benefiting from these trust fund projects.***

## **FOLLOW UP TO 2004-2005 AUDIT RECOMMENDATIONS**

### **Adoption of IPSAS**

56. In our 2004-2005 report we recommended that that INCAP work closely with PAHO to prepare a detailed strategy for a move to International Public Sector Accounting Standards. The strategy should identify the resources, human and other, required and how INCAP plans to deliver these. Achievable milestones should be identified and management should establish appropriate arrangements to ensure that they are achieved. At present INCAP is adopting the step-by-step changes implemented by PAHO as part of their strategy to move to IPSAS. In 2006-2007, PAHO gained approval to amend their financial regulations to revise their expenditure recognition policy on goods and services delivered or contractually due to be delivered in this biennium.
57. As INCAP embarks on a transition from having a parent/child relationship with PAHO to becoming an independent body in its own right, a renewed commitment to compliance with IPSAS would be appropriate. INCAP should ensure that there is a strategy for IPSAS compliance and that appropriate steps are being taken. We have set out in Figure 3 below the key areas on which INCAP needs to focus in assessing how compliance with IPSAS can be achieved.

**Figure 3 - Major differences between UNSAS and IPSAS which affect INCAP**

UNSAS	IPSAS	Areas to be addressed by INCAP
<p><b>Accounting Basis</b></p> <p>Reporting requirements take a "modified accruals" approach that is similar to cash accounting.</p>	<p>Requirements are on a full accruals basis.</p>	<p>IPSAS reports a more complete group of items (assets and liabilities) on the balance sheet than UNSAS.</p>
<p><b>Fixed Assets</b></p> <p>Costs of fixed assets are reported as expenditure in the statement of Income and Expenditure when the assets are purchased.</p>	<p>Cost of fixed assets are capitalised and included on the balance sheet when first acquired. The original cost is spread over the useful life of that asset as a depreciation expense.</p>	<p>There will be a decrease in expenditure and an increase in assets reported.</p> <p>A capital reserve will need to be established upon initial recognition of existing fixed assets.</p>
<p><b>Employee Benefits</b></p> <p>Accrued employee benefits in respect of repatriation grants and annual leave can be reported in a narrative note to the accounts.</p>	<p>Full recognition is required of liabilities for employee benefits and reported as an expense.</p>	<p>An increase in reported expenditure and a corresponding increase in liabilities for the amounts accrued.</p>
<p><b>Expenditure</b></p> <p>Reported expenditure represents disbursements and unliquidated obligations (ULO's).</p>	<p>Recognition of expenditure on the basis of goods and services received. (The delivery principle).</p>	<p>There would be a reduction in reported expenditure as not all ULO's of the period would be recognised as expenditure.</p>
<p><b>Budgets</b></p> <p>Preparation of budgets on a cash basis.</p>	<p>Preparation of budget on an accrual basis.</p>	<p>Changes of content and format of budget due to adoption of accruals basis. Or a reconciliation between the two basis.</p>

58. Additional work is required to ensure that INCAP is fully prepared for IPSAS compliance. One of the key aspects which requires early attention is the ability of the Institute to identify accrued income and expenditure.

***Recommendation 5: We recommend that INCAP formulate a detailed plan for achieving IPSAS compliance and develop an action plan to ensure establishment of mechanisms for collecting the required accounting information.***

#### **Trust Funds: reliance on key donors**

59. In 2004-2005 we reported that INCAP had been dependent on a small number of key donors for trust fund income for the biennia 2002-2003 and 2004-2005. Trust fund income accounted for approximately 29 per cent of total income (\$1.82 million of \$6.3 million total income for 2004-2005). For 2006-2007 this increased to \$5,150,215, or 54 per cent of total income (\$9.5 million) and therefore continues to represent a key element of INCAP's funding.

60. The value of trust fund income to the Institute has increased by 183 per cent, from \$1.82 million in 2004-2005 to \$5.2 million in 2006-2007. We noted in our last audit report that over the previous two biennia, there had been five key trust fund donors providing a similar proportion of funds in each financial period. These donors accounted for 77 per cent of trust fund income in 2004-2005. In 2006-2007, INCAP increased the number of donors and the profile of donations is shown in Figure 4 below.

**Figure 4 - Dependence on Key Donors**

Donors	Value of 2006-2007 funding		Value of 2004-2005 funding	
	(\$)	% of total	(\$)	% of total
Central American Integration System	4,012,478	77.9	480,098	26.3
Federal Government of Belgium	247,734	4.8	-	-
Emory University	241,599	4.7	264,810	14.5
W.K. Kellogg Foundation	100,611	2.0	257,897	14.1
Other Donors	547,793	10.6	819,969	45.9
Total funding received	5,150,215	100	1,822,774	100
Total number of donors	18		12	
Percentage of funding from top 5 donors	91%		78%	

Source: *Financial Statements for 2006-07 and 2004-05*

61. While the number of donors has increased significantly, there is now a greater concentration in donor income from the Central America Integration System (SICA), which accounted for 78 percent of all voluntary contributions in 2006-2007 compared with only 26 percent in 2004-2005. \$1,425,285 (28 percent) of all trust fund income came from a single SICA project, the Presanca project.
62. The concentration of voluntary contributions income with one donor leaves INCAP heavily reliant on its relationship with SICA. If this particular source of funds diminished, this could have a significant impact on INCAP's planned programme of work.

***Recommendation 6: We recommend that INCAP continue to regularly review the profile of voluntary contributions donors and actively manage the risk of reliance on key donors.***

**ACKNOWLEDGEMENT**

63. We wish to record our appreciation for the willing co-operation and assistance extended by the Director and the staff of the Institute throughout the course of the audit.



**T J Burr**

**Comptroller and Auditor General, United Kingdom**

**External Auditor**

## ANNEX A

### AUDIT SCOPE AND APPROACH

#### Audit scope

1. We have examined the financial statements of the Institute of Nutrition of Central America and Panama (INCAP) for the biennium ended 31 December 2007 in accordance with Regulation XIV of the Financial Regulations of the Institute and the relevant audit provisions of the Financial Regulations of the Pan American Health Organization (PAHO).

#### Audit objectives

2. The main purpose of the audit was to enable us to form an opinion as to whether the expenditure recorded in the financial period had been incurred for the purposes approved by the INCAP and PAHO Directing Councils; whether income and expenditure were properly classified and recorded in accordance with the Financial Regulations; and whether the financial statements present fairly the financial position at 31 December 2007.

#### Audit standards

3. Our audit of the Institute's financial statements was carried out in accordance with International Standards on Auditing. These standards require us to plan the audit so as to obtain reasonable assurance that the Institute's financial statements are free from material misstatement. Management were responsible for preparing these financial statements and we are responsible for expressing an opinion on the statements, based on evidence collected in our audit.

#### Audit approach

4. In accordance with International Standards on Auditing, our audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. This audit included:
  - a general review of the Institute's accounting procedures;
  - an assessment of the internal controls for income and expenditure, bank accounts, and inventory;
  - a review of amounts recorded as accounts receivable and payable;

- substantive testing of transactions of all types;
  - substantive testing of biennium-end balances; and
  - a final examination to ensure that the financial statements accurately reflect the Institute's accounting records and were fairly presented.
5. These audit procedures are designed primarily for the purpose of forming an opinion on INCAP's financial statements. Consequently, the work did not involve detailed review of all aspects of financial and budgetary systems, and the results should not therefore be regarded as a comprehensive statement on them.

#### Audit conclusion

6. During the audit, we sought explanations as they considered necessary in the circumstances on matters arising from their examination of the internal controls, accounting records and financial statements. Observations on matters which we consider should be brought to the attention of the INCAP Directing Council are set out in this report. In accordance with normal practice, we also provide the Institute with management letters setting out the detailed findings resulting from their examination.
7. None of these matters materially affected our audit opinion on the Institute's financial statements for the biennium and, notwithstanding the observations in this report, the examination revealed no weaknesses or errors that we considered material to the accuracy, completeness and validity of the financial statements as a whole. Accordingly we have placed an unqualified audit opinion on the financial statements of the Institute for 2006-2007.