



**INTERNATIONAL TROPICAL
TIMBER COUNCIL**

**COMMITTEE ON
FINANCE AND ADMINISTRATION**

Distr.
GENERAL

CFA(XXXV)/8
13 November 2020

Original: ENGLISH

THIRTY-FIFTH SESSION
9 – 13 November 2020
Virtual Session

REPORT TO THE INTERNATIONAL TROPICAL TIMBER COUNCIL

**THIRTY-FIFTH SESSION OF THE
COMMITTEE ON FINANCE AND ADMINISTRATION**

Item 1: Opening of the Session

1. The Chairperson of the Committee on Finance and Administration (CFA), Ms. Katharina Kuehmayer of Austria, welcomed all delegates to the Thirty-fifth Session of the Committee.

Item 2: Adoption of Agenda and Organization of Work

2. Due to the COVID-19 pandemic and global travel ban, it was decided that the Fifty-sixth Session of the Council would be held virtually using a web conference system. As this decision allowed limited time to be allotted to discuss Committee-related agenda items during the Session, the Chairperson, through the Secretariat, requested Member Countries to provide comments to the CFA documents prior to the opening of the Council, so that their comments would be incorporated in the CFA Report as interventions. Furthermore, it was decided that agenda items on the possible development of a policy and procedures for the use of the Working Capital Reserve, follow up on Liberia's request for 'Relief from Obligations' and additional policies for the governance of the Organization would be deferred to the next Committee Session to best utilize the limited time available at the Fifty-sixth Session of the Council. As there were no comments received on the Provisional Agenda, it was adopted by the Committee as contained in document CFA(XXXV)/1.

Item 3: Admission of Observers

3. The Council had admitted all applicants shown in document ITTC(LVI)/Info.3, which lists states, intergovernmental and non-governmental organizations applying for Observer status. The Committee in the past has been open to all observers, except, in accordance with the rules of procedure, on those agenda items that are restricted to Members only, in which case observers would be requested to leave the room. As there were no comments, the Committee approved the admission of observers following past practice.

Item 4: Approved Biennial Administrative Budget for the Years 2020 and 2021

4. At its Fifty-fifth Council Session in December 2019, the Council approved the draft Administrative Budget for the Biennium 2020 and 2021 in accordance with Article 19(4) of the ITTA, 2006. This document was revised to include the combined host contribution, comprising the City of Yokohama and the Government of Japan as request by the delegate of Japan at the Thirty-fourth Session of the CFA, and was made available to Members as Document CFA(XXXV)/2.

5. The delegate of Indonesia inquired whether there is any impact of COVID-19 on the budget of Council meetings located in the Budget Heading I (Cost Met by Japan) and wondered whether the current crisis due to the pandemic had been addressed in the financial and administrative documents prepared by the Secretariat.

6. The Secretariat explained that the actual expenses for the ITTC56 virtual Session for 2020 will be much lower than originally budgeted and any savings will be returned to city of Yokohama who will be reimbursing Council costs based on actual expenses incurred. The Secretariat also explained that the impact of the COVID-19 pandemic and exigencies was discussed and reported in the Report of the Informal Advisory Group (IAG) (ITTC(LVI)/2), which has already been made available to all Members.

7. The delegate of the EU expressed their acceptance of document CFA (XXXV)/2, in which the approved Administrative Budget for the Biennium 2020 and 2021 had been revised to include the combined host contribution, comprising the City of Yokohama and the Government of Japan (not included in total). However, they requested the Secretariat to further revise the document, with regard to contributions for 2021 for consumers (page 17 of document CFA(XXXV)/2), to remove the United Kingdom as a member of the European Union. This is due to the United Kingdom having withdrawn from the European Union since 1 February 2020. Hence, the assessed contribution and votes for the UK needed to be listed separately from the EU, involving a recalculation of votes accordingly.

8. The Secretariat amended the document accordingly to reflect the European Union's request (document CFA(XXXV)/2 REV. 1).

Item 5: Review of Contributions to the Administrative Budgets

9. Document CFA (XXXV)/3 dated 1 October 2020 detailed the status of members' contributions to the Administrative Budgets for the financial years from 1986 to 1 October 2020, including assessments, receipts, interest charges, and arrearages in contributions. In 2020, \$1,566,706.03 had been received from producer members out of the total net assessment of \$3,311,658.00; and \$3,701,634.00 had been received from consumer members out of the net assessed amount of \$3,779,830.00.

10. The arrearages in contributions to previous years' budgets from producer members amounted to \$6,206,315.31 and arrearages from consumer members amounted to \$282,945.00. The amount outstanding from this year's assessment was \$1,744,951.97 for producer members and \$78,196.00 for consumer members. Furthermore, arrearages in contributions from former members of the Organization amounted to \$1,738,049.28, bringing the total outstanding arrearages to \$10,050,457.56.

11. The delegate of the EU reiterated the importance of the support of all members to ITTO in order for the Organization to fully recover financially and the timely payment of assessed contributions. They further reiterated that ITTO needs to closely work with the members with arrears to identify a suitable payment plan that will allow each one of them to meet their financial obligations.

12. The delegate of the United States took note of the level of outstanding assessed contributions. The United States urges members to make timely payments and encourages the Secretariat to continue its efforts to reduce the level of outstanding assessed contributions for the financial health of the organization.

13. The Committee took note of the report.

Item 6: Current Status of the Administrative Account

14. Document CFA (XXXV)/4, dated 1 October 2020, reported on the current status of the Administrative Account for the financial year 2020, together with the estimated expenditures for the current year.

15. Section A of page 1 of the document showed that the estimated total expenditures for the financial year 2020 would amount to \$5,696,870.95 (i.e. \$1,394,616.05 less than the total amount approved in the budget for 2020 of \$7,091,487). The total contributions received from both producer and consumer members amounted to \$5,268,340.03, and it was anticipated that a deficit in the amount of \$701,530.91 would accrue in 2020. This amount would be deducted from the Working Capital Reserve.

16. Section B showed that the current year's arrears in contributions amounted to \$1,823,147.97. Total arrears for the period 1986–2019 amounted to \$6,161,991.77 for producer members, and \$282,945.00 for consumer members, and \$1,707,005.72 for former members. The interest charges on these arrears in contribution amounted to \$75,367.10. Total outstanding contributions to the Administrative Account, including interest charges, amounted to **USD 10,050,457.56**.

17. Section C showed the Special Reserve Fund of \$2,500,000, which was to be used only on Council approval in the event of the liquidation of the Organization.

18. Section D showed that the resources of the Working Capital Reserve were estimated to increase from the year's opening balance of \$5,167,832.56 at the beginning of 2020 to \$5,348,818.72 by the end of 2020.

19. Section E showed an interest income balance of \$231,743.81, which was to be used by the Executive Director for hiring consultants in accordance with the Financial Rules, Rule 5(10).

20. The document also contained details of expenditure for each budget item and where savings were made.

21. Annex 1 contained information required by the new Financial Rules to be brought to the attention of the CFA. This included a list of procurements greater than USD 100,000; sole suppliers; bad debts that were written off; and banks and financial institutions approved by the Council.

22. The delegate of the United States took note of the estimated deficit of \$701,531 when viewed in the context of the contributions received and expenditures incurred, and recognized that received arrears and interest payments should offset the current assessment shortfalls and likely result in an overall surplus in working capital reserve by about 3.5 percent. Despite the remedy, the United States highlights that the stated deficit highlights ITTO's continued reliance on assessed contributions in order to meet its operating expenses, and strongly encourages Council to continue to advance work under the programmatic lines approach to pursue alternative and additional means of revenue.

23. The Committee took note of the report.

Item 7: Resources of the Special Account and the Bali Partnership Fund

24. Document CFA (XXXV)/5 dated 1 October 2020, on "Resources of the Special Account and the Bali Partnership Fund", captured the current balance of funds under the Special Account and the Bali Partnership Fund.

25. In accordance with the Terms of Reference of the CFA, as contained in Decision 7(LII), the CFA shall "review the assets and liabilities of the Organization and make recommendations to the Council on prudent asset and cash flow management and levels of reserves needed to carry out its work." Document CFA(XXXV)/5 served as a reference for reviewing the assets and liabilities of the Administrative Account, and this document was prepared as a reference to review the assets and liabilities of the Special Account and the Bali Partnership Fund.

26. The current balance of funds under the Special Account and the Bali Partnership Fund is \$15,373,846.17, of which \$12,799,736.32 are funds committed to specific projects and activities. The unearmarked funds and the Sub-account B of the Bali Partnership Fund, which had a balance of \$67,061.68, may be allocated to projects/activities by the Panel on Sub-Account B of the Bali Partnership Fund, which is normally convened during the period when the Council Session is held. However, as recommended by the Informal Advisory Group (IAG), it was decided that the Panel would not be held during this Session due to low levels of funding.

27. The Committee took note of the report.

Item 8: Auditor's Reports for the Financial Year 2019

28. Document CFA (XXXV)/6 on the "Financial Reports Prepared in Accordance with ITTO Financial Rules and Procedures (Annex 4)" contained two reports required to be submitted by the ITTO Auditing Standard: The Executive Summary of ITTO's Financial Statements for the year ended 31 December 2019 prepared by the ITTO Management; and ITTO's Financial Statements for the year ended 31 December 2019, audited by the Independent Auditors.

29. The audit was carried out by Ernst & Young Japan, appointed by the Council in November 2017 to audit the Accounts of the Organization for the financial year. It carried out the financial audit for the period ending 2019 during the months of March to June 2020.

30. The audited financial statements provided information on the financial position and performance of ITTO for the fiscal year ended 31 December 2019 (FY2019).

31. For ITTO's Project accounts in FY2019, new voluntary contribution pledges of \$5.1 million were announced at the Council Session, while total project cost expenses during this period was \$5.6 million from projects mostly funded prior to FY2019. Total Administrative Account assessed contribution revenues were \$7.2 million, of which \$1.7 million was not received during FY2019 and accounted for as assessed contributions receivable (arrears).

32. In November 2018, Council adopted Decision 5(LIV) at its 54th Session for enhancing the financing architecture and fundraising of the Organization. Additional fundraising approaches would be piloted and new streamlined project cycles and programmed themes were to be developed from 2019 in accordance with this decision. Information on revenue, direct and indirect costs associated with implementing this pilot would also be reported in the financial statements for calendar years 2019, 2020 and 2021, in accordance

with this decision. For calendar year 2019, it was reported that total pledges of \$2,469,636 were made associated with implementing the pilot and total cost associated with implementing the pilot was \$303,076.

33. Other highlights include, among others:

- The surplus for the FY2019 was \$0.5 million due to differences in the timing of recognizing revenue and expenses (e.g. the entire Administrative Budget is recognized as revenue in the year that the assessments are due, but only expenses incurred during the same year are recognized as expenses from that year's budget).
- Deferred revenue decreased by \$1.2 million between 2018 and 2019. This was due mainly to projects pledged in prior years making progress in 2019.
- Additional disclosures on ITTO's financial accounts as defined under the ITTA, 2006 (Administrative Account, Special Account and Bali Partnership Account) have been added for increased transparency of core and non-core accounts.

34. Document CFA (XXXV)/CRP-1, "Management letter prepared by the independent auditors for ITTO management" was a letter submitted to the CFA meeting in accordance with the ITTO Auditing Standard and contained information on matters affecting the completeness or accuracy of the accounts and other matters that should be brought to the notice of the CFA that the auditors identified during their audit. No significant items were identified in ITTO's latest audit. The auditors provided their satisfactory opinion on ITTO's financial statements, noting that the financial statements were prepared in accordance with IPSAS, with no material misstatements or issues.

35. The delegate of Japan explained that they had requested at the last Council Session to refer to Japan's payment as "Host Country Contributions", as done in other Conventions. They also requested to see Japan's contributions in the budget tables, for transparency and consistency, instead of as a mere foot note, and expressed disappointment that these requested changes did not appear in the document. Additionally, Japan requested Note 20 to refer to "Host Country Contributions" -- not "voluntary contributions", as it provides a lot more clarity and in line with standard practice.

36. The Secretariat explained that the specific request made by Japan at the ITTC55, recorded in paragraph 12 of the CFA report (CFA(XXXIV)/9) under the agenda item for the "Draft Biennial Administrative Budget for the Years 2020 and 2021", was the "inclusion, by next Council Session, of the combined host contribution, comprising those of the City of Yokohama and the Government of Japan." The report further indicates that Japan referenced Table 1 in document CFA(XXXIV)/2 when making this request. Hence, the Secretariat made the necessary amendments to the said table and presented the revised document as CFA(XXXV)/2, as mentioned under Item 4 of this year's committee agenda. The Secretariat took note of the request to add "Host Country Contributions" to the "Statement of comparison of budget to actual amounts" in the financial statements and this will be considered, in consultation with the ITTO auditors, for possible inclusion next year.

37. The delegate of Japan sought clarification on the drivers of steady increases in project evaluation expenses, since 2017 (whether it was structural and could be a scalable item), and whether the Secretariat could explain how the picture has changed with COVID-19 in 2020 and how there may be variance in the budget. At the same time, they expressed that they were surprised that there is no request to adjust the budget categories (under CFA(XXXV)/2).

38. The Secretariat clarified that the project ex-post evaluation funds were utilized in 2016 to cover the financial impairment and many projects were also suspended during this time. The ex-post evaluation funds were gradually replenished from 2017 onwards as projects were resumed and new projects were completed. The Secretariat further clarified that the project evaluation expenses may increase if the overall volume of projects implemented increase. However, the source of these costs should be covered by the evaluation costs budgeted in each project.

39. Referring to Japan's comment on the effects of COVID-19 on the budget, the Secretariat explained that there have been savings in travel, the expert panel and Council costs in 2020, but on the other hand, no substantial new items were incurred. Furthermore, Rule 3, para 3 of the Financial Rules allows for the Executive Director to, should very exceptional circumstances so require, submit to the Council proposals for supplementary expenditure during any financial year. Since there are no supplementary expenditures

envisioned for 2021, the Secretariat explained that there is no request to adjust the budget categories submitted to the Committee at this time.

40. The delegate of the EU thanked the Secretariat for the preparation of the Financial Statements and encouraged ITTO to continue the transparent and effective financial management, as well as congratulating the Executive Director for the successful efforts piloting an additional fundraising approach and encouraged its continuation. They also expressed concerns on the effects of the continued COVID-19 pandemic on the operations of ITTO and highlighted the need for strong leadership that will steer the Organization through this dire situation, as well as the need for support to the ITTO by all its members.

41. The delegate of the United States congratulated ITTO on the surplus achieved during this financial period.

42. As there were no other comments, the Committee decided to recommend to the Council that it approve the "Financial Reports Prepared in Accordance with ITTO Financial Rules and Procedures (Annex 4)" on the Accounts of the Organization for the financial year 2019, as contained in document CFA (XXXV)/6.

43. The Committee concluded that the auditor's performance was satisfactory and decided to recommend to Council at this Session the re-engagement of Ernst & Young Japan to audit the Organization's Accounts for the financial year 2020.

Item 9: New Project Audit Framework

44. Document CFA (XXXV)/7, on the "New Project Audit Framework", contains the background and proposed text for ITTO's new project audit framework.

45. Ernst & Young Japan emphasized, in its recommendation to the ITTO Management in 2018 for ITTO's financial statements audit, that audit reports received from the project executing agencies were an essential source of information in estimating project expenses, which is a key element under the International Public Sector Accounting Standards (IPSAS) reporting framework. Simultaneously, they noted that for some project audits there may be issues with timely reporting and reliability of the locally selected auditors to detect errors and internal control weaknesses under the current project audit framework, hence recommended that ITTO explore ways to improve the process. The secretariat proceeded to develop and test a new project audit framework based on relevant international standards which requires auditors to report in detail on any issues found with management of funds and/or internal control weaknesses, in accordance with applicable ITTO rules. The new project audit framework was further reviewed by an independent audit firm for compliance with relevant international standards and effectiveness to detect material issues. The Secretariat proceeded to test the new approach on select projects under the draft framework: PD646/12 Rev.3 (F) and PD777/15 Rev.3 (F) in 2019 and PD732/14 Rev.2 (M) in 2020. The results of the trial were shared with Ernst & Young, who were satisfied with the results and recommended to ITTO management that this new framework be applied to all projects with executing agencies.

46. The new project audit framework contains the following elements:

- Terms of reference for the auditor detailing the procedures for the project audit (Annex 1), which requires the auditors to undertake the engagement in accordance with the International Standard on Related Services (ISRS) 4400 and IFAC Code of Ethics for Professional Accountants
- A detailed factual finding reporting format (Annex 2), which requires auditors to describe results of each test conducted and any issues found
- An updated financial statements' reporting format for better compatibility with IPSAS's accrual-based accounting (Annex 3)

47. The new framework would be applied as follows:

- A final audit is required upon completion of all projects/activities which transfer funds to an executing agency. In addition, an annual audit is required if the budget of the executing agency is \$200,000 or more.
- Audit reports are to be completed within 3 months from the end of the year for annual audits and 4 months from the completion of the project/activity for final audits.

- ITTO retains the audit budget and directly contracts the auditor. The annual audits for various projects could be conducted at the same time through a single global firm to save costs and ensure timeliness of reporting.
- The audit budget in future projects should reflect the requirements of the new framework whilst ensuring sufficient funds for such audits to be conducted.
- Additional paragraphs (contained in Annex 4) will be added to project agreements to reflect the above changes.

48. The delegate of Malaysia recognized the importance of ensuring sufficient funds are available to enhance the capacity of producing member countries to meet the objectives of the ITTA. Malaysia further acknowledged ITTO's efforts to strengthen internal controls and decision making processes through the implementation of IPSAS accounting requirements, in order to increase transparency, effectiveness and integrity of the Organization. Hence, Malaysia wished to seek ITTO's feedback on the proposed project audit framework as follows: (1) Who would be responsible in ensuring the financial audit report to be completed within the time frame; and (2) Why there was no specific clause in the proposed framework that explained that the auditor appointed by ITTO must be based in the Executing Agency's country or not. Overall, Malaysia expressed its support for the proposed project audit framework.

49. On Malaysia's first question, the Secretariat explained that, as a contracting party to the audit agreement, ITTO and the appointed auditors would be ultimately responsible in ensuring the financial audit report is completed within the time frame. However, the full cooperation of the executing agency is essential to enable the completion of this task in a timely manner. On their second question, the Secretariat explained that there is no specific clause on this matter in order to allow flexibility in the selection of the most suitable auditor for the task, which may require auditors to travel from neighboring countries in some cases.

50. The delegate of Japan commended the Secretariat for preparing a timely report and initiative and sought clarification on the rationale for the \$200,000 budget threshold for annual audits and whether the framework aligns with the procedures/requirements typically used in multilateral development banks (including GEF, GCF) and their partner agencies, as it may facilitate the accreditation process. The delegate further requested for the addition of the word "independent" ahead of the word "audit" in the 3rd paragraph of CFA(XXXV)/7.

51. The Secretariat explained that the \$200,000 threshold is aligned to the current budget threshold in the ITTO project manual for projects requiring annual audits, and that the framework is based on the International Standard on Related Services (ISRS) 4400, which is the international standard used in similar frameworks. The Secretariat also took note of the request for adding text and revised the document accordingly.

52. The delegate of Indonesia said that the new project audit framework to enhance governance of projects and activities has not considered efforts to build back better from the current COVID-19 crisis.

53. The Secretariat explained that the new framework has the flexibility to take into consideration special and or national circumstances as necessary, which may become an issue next year due to exigencies of COVID-19 if the pandemic continues.

54. The delegate of EU thanked the Secretariat for the development and testing of the new project audit framework based on relevant international standards, and welcomed the proposal and agreed to its adoption and recommendation for immediate implementation of all future audits.

55. The delegate of Japan emphasized that, in addition to complying with the new audit framework, it hopes to see members promptly submit comprehensive final reports on the projects that were funded, as not doing so will hamper the ability to close projects, with adverse effects on future capacity to generate contributions.

56. The committee decided to recommend to the Council to adopt the new project audit framework as contained in CFA(XXXV)/7 Rev.1 with immediate effect for all future audits.

Item 10: Election of Chairperson and Vice-Chairperson for 2021

57. The Vice-Chairperson of the Committee for 2020, Ms. Teresa Guila Nube of Mozambique, was elected Chairperson of the Committee for 2021. The Vice-Chairperson of the Committee for 2021 would be announced by the consumer caucus at a later date.

Item 11: Dates and Venue of the Thirty-sixth and Thirty-seventh Sessions

58. The Committee agreed that its Sessions may be held on the same dates and at the same venues as the Fifty-seventh and Fifty-eighth Sessions of the Council.

Item 12: Other Business

59. The delegate from the United States recalled the report of the 34th Session of the CFA in which the committee recommended to Council:“(6) To request the Secretariat to initiate a process of consultation with ITTO members and partners on additional policies for the governance of the Organization, and to present a draft of these policies for the Council’s consideration at its next Session”. While recognizing the adapted ITTC-56 session limited time to address the issue this year, the delegate of the United States requested that an item be included in the CFA agenda for its next session to consider additional policies, both financial and non-financial, to strengthen governance and bring the ITTO into greater alignment with the accreditation criteria of certain multilateral donor funds. The delegate of the United States suggested the Committee could refer to draft document CFA(XXXIV)_CRP-2_Rev1_“Draft Policy Documents” which the Committee discussed at its last session.

Item 13: Recommendations to the International Tropical Timber Council

60. The Committee decided to make the following recommendations to the Council:

(1) To approve the Financial Reports prepared in accordance with ITTO Financial Rules and Procedures (Annex 4) for the Financial year 2019, as contained in document CFA(XXXV)/6;

(2) To continue to appoint Ernst & Young Japan, Tokyo, to audit the Accounts of the Organization for the financial year 2020;

(3) To take note of the list of disclosures required by the Financial Rules as contained in Annex 1 of CFA(XXXV)/4 and:

- a) Endorse the list of sole providers;
- b) Approve the list of bad debt write off;

(4) To adopt the new project audit framework as contained in CFA(XXXV)/7 Rev.1 with immediate effect for all future audits; and

(5) To examine and take actions to secure the needed resources to achieve the objectives of the Organization.

Item 14: Report of the Session

61. The Committee adopted this report as amended.
